THE INSTITUTE OF INSOLVENCY (BANKRUPTCY) IN SOME FOREIGN COUNTRIES: BASIC ELEMENTS

V.S. BELYKH,
Director of the European-Asian Scientific and Research Centre of Comparative and International Business Law, Distinguished Scientist of the RF, Doctor of Law, Professor, Head of the Entrepreneurial Law Department of the Ural State Law University (Yekaterinburg, Russia)

The article focuses on some basic elements of the institute of insolvency in industrially developed countries. First of all, the author makes a review of acts on insolvency in England, the U.S. and in continental Europe, and secondly, of subjects of insolvency (bankruptcy): both physical and legal entities (companies). The article analyses the main systems of regulating insolvency (bankruptcy): pro-creditors and pro-debtors regulation.

Keywords: the institute of insolvency (bankruptcy), legislation on insolvency, acts (statutes), acts of delegated legislation, judicial precedents, subjects of insolvency (bankruptcy), main systems of regulating insolvency (bankruptcy).

1. Legal regulation of bankruptcy proceedings abroad. In countries with developed economies, the market is rather saturated with goods and services, with competition being a driving force of economic development and social progress. Bankruptcy, in its turn, is considered a part (an element) of ordinary operation of the market economy. These countries have developed and successfully applied the *general concept of bankruptcy* under which entrepreneurial activity is viewed as useful, desirable and socially important. Any entrepreneur, found bankrupt, is entitled to a fair and objective assessment of their efforts and actions. Therefore those entrepreneurs who have acted diligently and in good faith - though in the conditions of fierce competition they have become bankrupt – are not deprived of an opportunity to continue their entrepreneurial activity.[1]

Different countries have their own legal regime in case of bankruptcy. First of all, such a distinction is based on the type of a legal system that a country belongs to: it is either a common-law country or a civil-law country, or a Muslim country, etc.[2] Thus, English law is primarily case law, with an increased role of laws (statutes) and acts of delegated legislation in regulating public relations. Conversely, the law of continental Europe is characterized by a significant influence and development of legislation.

However, civil-law countries face some difficulty in balancing the current legislation and their judicial practice. In many countries of continental Europe, judicial practice and

[1]Reshetnikov F., Ignatova M. Bankrotstvo v dorevoliutsionnoi Rossii i na Zapade [Bankruptcy in pre-Revolutionary Russia and in the West] // Zakon. 1993. No. 7. Pp. 53-59.

[2]See: Legea Raymond. Velikie pravovye sistemy sovremennosti: sravnitel'no-pravovoi podkhod [Great Law Systems: a Comparative Law Approach] translated from French by A.V.Gryadov. M., 2009. – 584 p.

its form – a judicial decision – is not formally considered a source of law. So, the French Civil Code (Art.5) prohibits judges adjudicating certain cases to adopt generally worded judgments. Formally speaking, judicial practice is not a source of law in Germany as well as in some other countries. For example, decisions of the Federal Court of Germany are not binding for lower courts. The Federal Court of Germany has the right to refer a case to a lower court in the cassation proceedings. The review of a case by the Federal Court of Germany is reduced to considering a question whether the lower court has rightly applied the law.

Let us briefly analyze major acts related to insolvency (bankruptcy) in England and the U.S. – in common-law countries. England regulates matters of insolvency (bankruptcy) of legal entities by statutes, and in particular, by the 1986 Insolvency Act and the 1986 Company Director Disqualification Act.[3] The source of law on insolvency is case law.[4]

The U.S. has federal legislation on bankruptcy which is mostly statutory. In 1978, the U.S adopted Law No.95-598 (Bankruptcy Reform Act of 1978), which is well-known as the Bankruptcy Code. The new Act (preceded by the Act on Bankruptcy of 1898) came into force on 1 October 1979. The Bankruptcy Code is a complex and fundamental law; however, while analyzing and applying it, special attention is to be paid to Chapters 7 and 11 related to the liquidation of a bankrupt and its reorganization.[5] The use of a form of a code is rather conditional. In fact, the federal legislation of the U.S. is stipulated in the Restatement of Laws which includes 50 sections separated by a branch of law or an institute of law, or a type of activity (for example, Section 1 "General Conditions", Section 11 "Bankruptcy", Section 12 "Banks and Banking Activity", Section 15 "Commerce and Trade", Section 45 "Railways", Section 46 "Sea Navigation", Section 49 "Transportation", etc.).[6] The Reinstatement of Laws in the U.S. is reissued every six years. At the same time, rules on bankruptcy are stipulated in legal acts of states, though the principle of supremacy of federal laws prohibits state legislatures to adopt laws on bankruptcy. At the same time, the Bankruptcy Code provides for a possibility either to apply the rules of a state or refer to the general concepts of common law developed in a particular state. It is quite interesting!

Among the countries of continental Europe let us consider legal acts on insolvency (bankruptcy) in Austria, Belgium, Germany, France, and Sweden. So, in the Austrian law on insolvency, a leading role belongs to the Bankruptcy Proceedings Act adopted in 1914 with further amendments. Bankruptcy proceedings in Belgium are regulated by

[3]Butterworth's Commercial and Consumer Law. Third edition / ed. by Gwyneth Pitt. London, Edinburgh, Dublin, 1999. Pp. 745-854.

[4]English common law is not a source of law for the whole Great Britain; it is applied only in the territory of England and Wales, while Scotland, Northern Ireland, the Isle of Man and islands in the English Channel do not belong to the system of common law. For example, Scotland follows not English but Scottish law which has some distinctive features. See: Romanov A.K. Pravovaia sistema Anglii [The Legal System of England] M., 2000. P. 79.

[5]See: Bankruptcy Code and Related Legislation, Legislative History, Editorial Commentary. 2000-2001 ed. / William L. Norton. New York: West Group, 2001.

[6]See: URL: http://www.gpoaccess.gov/uscode/browse.html

the relevant Act passed on 18 April 1851, amended but still effective.[7] On 2 December 1877, Germany passed the Bankruptcy Ordinance (in the redaction of 1898), however, the XX century saw more than 20 laws adopted to alter or complement the current Ordinance.[8] In 1994, the German Parliament adopted a new bill on insolvency which came into force on 1 January 1999.[9] Such a time gap was necessary for interested subjects to study the bill to be passed and prepare the necessary ground for its application.

The authors of the course "Bankruptcy Proceedings" say that France has the following effective laws: Act No. 84-148 passed on 1 March 1984 on preventing and solving financial problems of an enterprise; Act No.85-98 passed on 25 January 1985 on rehabilitation and liquidation of enterprises (a more often term to be used: on recovery of enterprises and elimination of property in court proceedings); Act No. 94-475 passed on 10 June 1994 and Decree No. 94-910 passed on 21 October 1994 on executing the Act.[10] However, another source of information says that these laws were included into Book VI of the French Commercial Code of 1999 and became ineffective.[11] In fact, such information is confirmed by Book VI of the French Commercial Code.[12]

In its turn, Sweden has passed a series of normative acts: Act on Bankruptcy Proceedings passed on 1 June 1987 and Bankruptcy Discharge Act which became effective on 1 July 1994 which scope of application is limited by citizens, Act on the state-guaranteed salary in bankruptcy proceedings, Act on the preferential right in bankruptcy proceedings.

2. Subjects of insolvency (bankruptcy) are individuals as well as legal entities. In Germany, such a status can be acquired by a person regardless of their activity and commercial status that are "unable to pay". Exceptions are public legal entities as well as federation and its constituent entities (lands). Proceedings in cases of insolvency can be initiated in respect of any entity without the rights of a legal entity (for example, an open trade company, a limited partnership, etc.). Physical entities – consumers – are found insolvent if they and their creditors have failed to reach a corresponding agreement.[13] An individual can be declared insolvent only if such a person has been engaged in some entrepreneurial activity (business).

[7]See: Konkursnoe proizvodstvo: uchebno-prakticheskii kurs: Uchebnik [Bankruptcy Proceedings: Theoretical and Practical Course: a Course Book] / ed. by V.V. Yarkov. – Pp. 427 – 432.

[8]Grazhdanskoe i torgovoe pravo kapitalisticheskikh gosudarstv: Uchebnik [Civil and Trade Law of Capitalist States: a Course Book] / ed. by E.A. Vasiliev. M., 1993. Pp.442-443.

[9]Stepanov V.V. Nesostoiatel'nost' (bankrotstvo) v Rossii, Anglii, Frantsii, Germanii [Insolvency (Bankruptcy) in Russia, England, France, Germany] M., 1999. – Pp. 33-34.

[10]Konkursnoe proizvodstvo: uchebno-prakticheskii kurs: Uchebnik [Bankruptcy Proceedings: Theoretical and Practical Course: a Course Book] / ed. by V.V. Yarkov. M. P. 494.

[11]See: Kommercheskoe pravo zarubezhnykh stran: Uchebnik [Commercial Law of Foreign Countries: a Course Book] / ed. by V.F. Popondopulo. St.P., 2005. P. 119; Grazhdanskoe i torgovoe pravo zarubezhnykh stran: Uchebnoe posobie [Civil and Trade Law of Foreign Countries: a Coure Book] / ed. by V.V. Bezbakh, V.K. Puchinsky. M., 2004. P. 470.

[12]Kommercheskii kodeks Frantsii [Commercial Code of France] / foreword, transl. from French, with additions and comments by V.N. Zakhvataev. M., 2008. – Pp. 1035-1097.

[13]Kommercheskoe pravo zarubezhnykh stran: Uchebnik [Commercial Law of Foreign Countries: a Course Book] / ed. by V.F. Popondopulo. St. P., 2005. P. 122.

France has a **similar** regulation on the subjects of bankruptcy. In accordance with Article *L.* 631-2 of the FCC, the procedure of recovery is applicable to any vendor, craftsman, farmer, or any other individual involved in independent professional activity, including any freelance work, or to any physical entity of private law. There is also a simplified procedure of bankruptcy for physical and legal entities if their staff includes not more than 50 employees and their turnover does not exceed the established volume (limit).

In England, the 1986 Act on Insolvency covers not only individuals but also companies incorporated following the order established by the 1989 Act on Companies (at present – the 2000 Act on Companies) (excluding insurance companies, banks and other credit organizations the legal status of which is regulated by special statutes). The latter include: Banking Acts of 1979 and 1987, and the 1906 Marine Insurance Act. Subjects of insolvency (bankruptcy) can be non-registered companies acting under the English law. However, in respect of such subjects the procedure of voluntary liquidation shall not be applied under the current insolvency procedures.

After the 1979 reform, the U.S. has considerably expanded the list of subjects of bankruptcy. Not only individuals and traders, but any private persons can be subject to the Code on Bankruptcy. For example, in 1992 there were 900,874 cases of bankruptcy of individuals amounting to 42% of all bankruptcy cases. Such a trend is still obvious. The U.S. legislation differentiates between cases of insolvency of individuals with steady income, banks, insurance companies, brokers of stock and trade exchanges, railways, municipalities, family (farming) business with regular annual income. State formations (like states) cannot be found insolvent.[14]

Court proceedings in cases of insolvency (bankruptcy) are initiated by the motion of creditors, a debtor, and other persons by the decision of the court or at the request of the prosecutor. In the U.S., only the creditor and the debtor can initiate such proceedings. France and England have an expanded list of subjects who can initiate such proceedings. The law of such states provides for a possibility to initiate proceedings by the court to protect public interests. The French legislation vests such a right with the prosecutor of the Republic.[15]

The status of courts which adjudicate insolvency (bankruptcy) cases is different. In England and the U.S., cases of bankruptcy are tried by special courts. For example, such courts exist in 90 U.S. judicial circuits, with more than 300 judges administering justice. In France, such cases are tried by commercial courts, while in Germany there are civil courts adjudicating such cases.

3. Main systems of regulating insolvency. *Systems of insolvency* (*bankruptcy*) existing in industrially developed countries can formally be divided into pro-debtors and pro-creditors systems. Within the first model, we analyze different types of laws on insolvency, and namely moderate pro-debtors and radical pro-debtors systems.

[14]Kommercheskoe pravo zarubezhnykh stran: Uchebnik [Commercial Law of Foreign Countries: a Course Book] / ed. by V.F. Popondopulo. Pp. 122-123.

[15]See: Belykh V.S., Dubinchin A.A., Skuratovsky M.L. Pravovye osnovy nesostoiatel'nosti (bankrotstva): uchebno-practicheskoe posobie [Legal Foundations for Insolvency (Bankruptcy): a Theoretical and Practical Course]. Pp. 15-19.

A similar classification is available with the second (pro-creditors) system of insolvency (bankruptcy): moderate pro-creditors and radical pro-creditors legislation.[16] There is the so-called "neutral legislation" which equally takes into account the interests of both the creditor and the debtor. Let us briefly consider these systems.

Radical pro-creditors legislation is effective in Australia, England, Hong Kong, Israel, India, Ireland, Pakistan, etc. It is applied in Europe (except for France). Its main focus is on the protection of creditors' interests in a way of fully satisfying their claims and under the strict control over the maintenance of the debtor's assets and its timely liquidation. At the same time, there is no possibility to sue any third parties. The debtor's status as well as their economic interests are being ignored.

Moderate pro-creditors legislation takes into account the interests of other participants of bankruptcy proceedings (apart from creditors). This type of legal regulation of bankruptcy (insolvency) exists in Germany, Holland, Indonesia, Canada, Norway, Sweden, South Korea, Japan, and in resource-rich African states.

Pro-debtors legislation is also heterogeneous (both radical and moderate). It is focused on the protection of debtors' interests who for this or that reason have found themselves in a difficult financial situation. The state tries to create all the necessary conditions for such a subject to escape a critical situation, including a possibility to get rid of their debts and get a chance of a fresh start. The pure pro-debtors (radical) system of bankruptcy is known to exist in the U.S., taking into account the following facts: a) the debtor has acted within effective legislation and justice; b) entrepreneurial activity (business) is a risky activity; c) entering into the contract with the bankrupt-debtor, the creditor has the discretion to choose a partner and, therefore, the creditor bears all the risks of such a decision.

For the recent years, bankruptcy proceedings in France have acquired a "pro-debtors" bias, i.e. their purpose is to protect the interests of an insolvent debtor to the maximum extent (including the sole trader). The European Commission has recently stated that bankruptcy legislation of France tends to use the procedure of bankruptcy as a means of protecting the debtor from their creditors and render assistance in reorganization to financially recover the enterprise.[17]

Moderate pro-debtors legislation on insolvency makes a preference primarily towards the debtor's protection. But a series of legislative acts connected with the interests of the creditor and balancing this model of regulation make a sort of priority to a creditor as well. Such legislation is effective in Belgium, Greece, Spain, Portugal, Thailand as well as northern-western African countries.

As stated above, there is "neutral legislation" which harmoniously combines the interests of the creditor and the debtor. The states which "preach the principle of neutrality" in the

[16]See: Rosijskoe predprinimatel'skoe pravo: Uchebnik [Russian Entrepreneurial Law: a Course Book] / ed. by I.V. Ershov, G.D. Otniukov. 4th edition. M., 2012. Pp. 288-289; Vitrianskij V.V. Reforma zakonodatel'stva o nesostoiatel'nosti (bankrotstve) [The Reform of Legislation on Insolvency (Bankruptcy)] Bulletin of the RF Supreme Commercial Court. Special Attachment to No. 2. 1998. Pp.80–81; Belykh V.S. Conceptual Foundation of the 2002 Russian Insolvency Law // Russian Law: Theory and Practice. 2007. No. 2. Pp. 164-165.

[17]Legal Consequences of Bankruptcy. France // URL: http://ec.europa.eu/enterprise/policies/sme/files / sme2chance/doc/report_fra_en.pdf

legal regulation of insolvency (bankruptcy) include: Denmark, Italy, Slovakia, and the Czech Republic. Some commentators argue that the U.S. can also be considered as a state with neutral legislation on insolvency.[18] In our view, it does not correspond to reality. The American legislation is a product of an obvious pro-debtors system of legal regulation of insolvency.[19]

The Act on Insolvency of 1998 (as well as the Act on Insolvency of 1992) combined elements of both legal systems in regulating bankruptcy, that, in the view of V.V. Vitryansky, makes the national system on insolvency flexible, which enables to fully consider the conditions of insolvency of the debtor on a case-to-case basis.[20] The 1998 Act on Insolvency made a considerable breakthrough towards the pro-creditors system of insolvency. How reasonable the 'golden middle' is we can see in judicial and economic practice.

In our view, Federal Law on Insolvency of 2002 (Federal Law No.53-FZ redacted on 7 March 2018) is a type of *moderate pro-debtors act*. Such a bias is reflected in the **following factors**: To protect the debtors' interests the Law (Art.42) establishes the order of filing and accepting an application to find the debtor bankrupt, including an individual. Therefore the procedure of supervision over legal entities and sole practitioners shall be introduced upon the successful justification of claims by the applicant to the debtor, except for cases stipulated in p.2 of Art.62 of the Law. At the stage of filing an application, a conservative function of legal regulation of insolvency (bankruptcy) is exercised.

Further, the new Law adds to the list of pro-debtors judicial procedures. Alongside with institutions of supervision, external management and settlement, there has appeared *financial recovery* – a procedure applied to the debtor to restore their solvency and pay off their debts in accordance with the debt repayment schedule (Chapter V of the 2002 Insolvency Act). The emergence of this procedure can be explained in the following way: the legislator seeks to provide the debtor with expanded opportunities to protect their interests. The 1998 Insolvency Act contained a rule under which such a judicial measure as external management (judicial sanation) is applied to the debtor to restore their solvency, with the management powers being transferred to the external manager. **Thus**, at different stages of insolvency (bankruptcy), restoration of the debtor's solvency is a priority aim of the new Law on insolvency.

In our view, one of the reasons for pro-debtors policy is, first of all, connected with the economic situation in our country, especially under the crisis conditions. By experts' estimates, more than 40% of Russian enterprises are loss-making. In Russia, productivity of labour as a major factor contributing to competitiveness is five times lower than in the U.S. Nowadays we see that Russian technical and technological facilities are degrading.[21]

[18]See: Federal Law on Insolvency (Bankruptcy)/ ed. by V.V. Vitryansky. P. 7.

[19]See: Belykh V.S. Pravovoe regulirovanie predprinimatel'skoj deiatel'nosti v Rossii: monografiia [Legal Regulation of Entrepreneurial Activity in Russia: Monograph] M., 2008. P. 291.

[20]Vitryansky V.V. Reforma zakonodatel'stva o nesostoiatel'nosti (bankrotstve) [Reforming Legislation on Insolvency (Bankruptcy)] // Bulletin of the RF Supreme Commercial Court. Special Edition to No. 2. 1998. P. 85.

[21]See: Belykh V.S. Natsional'naia i ekonomicheskaia bezopasnost' Rossii – osnovnoj natsional'nyj proekt [National and Economic Security of Russia – the Major National Project] // Business, Management and Law. 2007. No.1. – Pp.16-25.

If under such a social and economic situation, preference is given to the protection of the interests of creditors, very soon we can see a major default with many enterprises in debt ceasing to exist as a result of mass bankruptcies.

Consequently, priority trends in the development of legislation on insolvency include: **a)** modernization of rules on criteria, features and elements of bankruptcy; **b)** review of provisions determining the status of the bankruptcy manager; **c)** elimination of a certain imbalance of interests of different subjects (creditors, the debtor, the owner, etc.) in regulating some stages of bankruptcy proceedings. But it is a subject for further independent research.

В.С. Белых: кейбір Еуропа елдерінде және Америка Құрама Штаттарында дәрменсіздікті (банкроттықты) құқықтық реттеу.

Мақалада индустриалды елдерде дәрменсіздік институтының негізгі элементтері қарастырылады. Біріншіден, Англияда, Америка Құрама Штаттарында және континенттік Еуропадағы дәрменсіздік туралы заңдарға шолу жасалады. Содан кейін дәрменсіздік субъектілері (банкроттық) субъектілері қарастырылады: жеке және заңды тұлғалар (компаниялар). Мақалада дәрменсіздік (банкроттық) реттеудің негізгі жүйелері несие берушілік пен борышқорлық талданады.

Тірек сөздер: дәрменсіздік (банкроттық) институты, дәрменсіздік туралы заңнама, заңдар (статуттар), берілген заңнама актілері, сот прецеденттері, дәрменсіздік (банкроттық) субъектілері, дәрменсіздік (банкроттық) реттейтін негізгі жүйелер.

В.С. Белых: **Правовое регулирование несостоятельности (банкротства) в некоторых европейских странах и в США.**

В статье рассматриваются основные элементы института несостоятельности в промышленно развитых странах. Во-первых, дан обзор законодательства о несостоятельности в Англии, США, странах континентальной Европы. Далее, рассмотрены субъекты несостоятельности (банкротства): физические и юридические лица (компании). В статье проанализированы основные системы регулирования несостоятельности (банкротства): прокредиторская и продолжниковская.

Ключевые слова: институт несостоятельности (банкротства), законодательства о несостоятельности, законы (статуты), акты делегированного законодательства, судебные прецеденты, субъекты несостоятельности (банкротства), основные системы регулирования несостоятельности (банкротвта).

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