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Doctoral Committee

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"*Debt restructuring as a measure for preventing bankruptcy under Russian and European law*" by Larisa Mastilovic
Review of the dissertation for the State University of St. Petersburg

Dear Members of the Doctoral Committee,

I am honoured to assist in the process of reviewing of the dissertation of Larisa Mastilovic. The selected topic of business rehabilitation options and procedures is a very timely one. Debt restructuring options have absorbed the attention of legislators across the world already before the pandemic. The need for well-adjusted restructuring procedures will be even more urgent when pandemic support measures are lifted and supported businesses will need to readjust their debt burden. I understand that the Russian legislator is considering law reforms in this area of law as well including restructuring mechanisms that prevent a formal bankruptcy. Ms. Mastilovic's dissertation fits well within this policy discussion.

The basic idea that a debtor who is actually unable to pay their dues may nonetheless agree with their creditors to lift the debt burden in order to continue the business and overcome the insolvency situation has been accepted almost globally and many jurisdictions have introduced relevant debt restructuring procedures in their bankruptcy laws since the 1990s. This includes Germany and, much more recently, Russia. The aftermath of the financial crises in the 2000s created the idea to expend court-based debt restructuring support to debtors who are not insolvent already but only foresee a scenario in which their insolvency is likely. The legal modification of debt requires the debtor to come to an agreement with the creditor. While this

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is difficult to achieve with a single creditor, it becomes even more complex when a coordinated attempt to restructure the debt owed to a group of creditors.

At the same time, the growing experience with restructuring plans in bankruptcy proceedings provided of set of tools that are obviously useful in achieving a coordinated debt restructuring. In the 2010s, many jurisdictions around the globe have followed this line of thought and introduced one formal proceeding or even a set of procedural options where a restructuring toolbox is made available to a debtor who is not yet insolvent. Their common function is to avoid a bankruptcy of the debtor in a timely process of debt adjustment. The EU legislator even initiated and, in 2019, adopted a binding Directive mandating all Member States to introduce such preventive restructuring procedures in their laws. Most prominently, Germany and the Netherlands introduced such procedures on 1 January 2021. The dissertation written by Larisa Mastilovic discusses the possibility and best ways to adopt a similar toolbox into Russian Law. This discussion is perfectly timed as it connects to the current debate in Europe and its insights. It provides stakeholders in Russia with relevant insights and may address common concerns.

Ms Mastilovic convincingly answers the underlying question whether preventive procedures are actually required at all in a jurisdiction, where things seemed to have worked well without them. It should be remembered that US law only allows a non-consensual debt restructuring in bankruptcy proceedings which – in exchange – the debtor may access anytime voluntarily without proving insolvency. Germany initially followed this approach when reforming their insolvency law in the 1990s. The US system works well because the perception of stakeholders and the public of voluntary Chapter 11 debt restructuring proceedings is clearly different than that of Chapter 7 bankruptcy liquidations. Chapter 11 procedures do not carry the negative image of bankruptcy. It has proven difficult to establish a similar public understanding in other jurisdictions. Germany is a good example that outside the US any bankruptcy process is perceived as a bankruptcy process. So the obvious idea is to separate the early debt restructuring option from the need to enter formal bankruptcy proceedings. Such "preventive" debt restructuring proceedings are now common in the EU and they were introduced also in Germany in 2021. Ms Mastilovic explains convincingly that Russian law would also benefit from their introduction. She is also right in her assessment that a "literal reception of European legislation into Russian law" would be "wrong" (p. 305). An adaptive solution is needed.

Based on this insight, Ms Mastilovic's dissertation provides a careful analysis of the subsequent question: how shall a new Russian preventive framework look like? Her well-explained answer

argues in favour of a differentiated, multi-level approach. Indeed, preventive procedures are neither necessarily "debtor-oriented" nor "creditor-oriented" (page 360). A closer look at their function, access criteria, procedural requirements and outcome options reveals that national legislator possess a significant degree of discretion in devising a functional framework which is capable of addressing the specific needs and institutional settings of their jurisdiction.

The expected outcome of any debt restructuring should be good for all stakeholders collectively. Creditors shall receive more under the plan than in the in alternative scenario of individual debt enforcement or of an imminent bankruptcy liquidation unless they actually agree to receive less in the interest of continued business relationship and future revenue. This general principle already reveals that not all creditors share the same general interest. Public creditors, for instance, are bound to significantly different standards in their claims management than, for instance, suppliers, customers, employees or banks of a debtor. While the immediate payoff may dominate the interest of the first, the latter may well be willing to receive less today in order to receive something for years to come. A well-designed restructuring procedure reflects this diversity in interests (class formation, differentiated treatment, guarantees for dissenting creditors). Overall, creditors shall do better and, consequently, one could comprehend such a procedure as creditor-oriented. It is also stakeholder-oriented because other stakeholders, especially employees, are benefiting from a rescue of the business as well. Overall, a rehabilitation procedure may well comprise a "social" principle in the way Ms Mastilovic describes it (pages 311 ff.).

Looking at the debtors, the outcome is in their interest, too. Debtors are able to continue their business with less debt to pay or at least a later date of payment. So rehabilitation procedures seem "debtor-oriented". But again, it is worth taking a closer look. The debtor is often not an individual but a company, which comprises of a variety of individuals. There are directors, majority and minority shareholders, some of which are mere financial investors while others are family business owners whose livelihood depends on the business. The specific outcome of a debt restructuring is not at all always or necessarily good for all of them. Management may be replaced, shareholders may see their shares transferred or diluted, which again may result in losing a controlling majority, even though the "debtor" is restructured and thus saved from bankruptcy. These conflicting interests require a close look at bad faith actions of managers with or even against shareholders and relevant practical means of prevention. I agree with Ms Mastilovic that disclosure of relevant information about the company's/debtor's affairs

to creditors and the court is key in any restructuring (page 229). A debtor who does not provide full and accurate information shall not succeed in preventive procedures. Creditors who are insufficiently informed shall be well entitled to veto a plan proposal. The access to preventive procedures shall indeed, as Ms Mastilovic explains, not depend on "signs of bankruptcy" (pages 349, 354), but on the ability of the debtor to fully explain the need to restructure.

Jurisdictions have typically introduced the involvement of a court in a restructuring endeavour of the debtor in two cases. First, the court is needed when the debtor signs a fully consensual agreement with all creditors, under which rights of potential third parties are affected. In particular, the limitation of rights under bankruptcy law, such as avoidance actions, to review the implementation of the contract often prompts the need for a court approval. French and Spanish law feature such a "conciliation" or "homolgation" prominently. Ms. Mastilovic' "out-of-court preventive rehabilitation agreements" follow the example of such institutions without copying them into Russian law.

The second, and probably more important, type of court involvement aims at sanctioning a restructuring agreement against the veto of some of the creditors (non-consensual agreements). Here, procedures are needed because debtors are not able to conclude a restructuring agreement with all (relevant) creditors due to hold-out creditors. Such restructuring plans or Schemes of Arrangements are the best restructuring tool available today in many jurisdictions (like e.g. the United States, the United Kingdom, Singapore, Germany, Canada, France, Spain). Recent law reforms even further relax the requirements for such plans and enable procedures to involve a subset of all creditors only if (1) such a partial solution is sufficient for the restructuring of the debtor's business and (2) the debtor selected the involved creditors in good faith. Here, efforts to restructure are limited to key (financial) creditors while not irritating others, especially employees and public creditors. Ms Mastilovic decided not to focus her analysis on such plans or schemes based on her assessment that many of such restructuring plans fail to rescue the business permanently. Coercive plans are also not able to impose new obligation on non-consenting creditors, which Ms. Mastilovic sees as a key feature of her proposal of an "out-of-court preventive rehabilitation agreement" (page 329).

This genuine focus does not at all mean, however, that Ms. Mastilovic is not aware of the power and efficiency of majority-based preventive plans. Preventive procedures that are able to overcome a veto position of a minority have proven helpful and deserve support as soon as the financial structure of businesses is characterised by the phenomenon of hedge fund

distressed debt investment. The origins of the 2019 Restructuring Directive gives prove that national legislators should not discard such more intrusive procedures once and for all. In Europe, we have come to the conclusion that the introduction of preventive plan procedures is adequate provided that creditors may be divided into classes of similar interest and a majority in a class suffices to confirm a plan based in the fulfilment of a fairness test to minority creditors. Safeguards matter. Ms Mastilovic indicates on page 349 that Russian court bankruptcy proceedings may well (continue to) feature such coercive procedures. The aim of her dissertation was obviously not to further detail such a process but to design a new procedural option, which is based on "absolute voluntariness" (page 349).

I have constraint my review to aspects in the dissertation of Ms Mastilovic that concern EU law or general bankruptcy law or contract law principles. I cannot assess to what extent Russian law specifics and legal culture are correctly reflected in this dissertation as I am not an expert in Russian law. In my view, these specifics seem well-addressed by the principle approach and the final outcome of Ms Mastilovic's thesis because she does neither advocate for a simple implementation of the EU 2019 Directive nor for the inclusion of another procedure under foreign law. Instead, she start from analysing the needs of Russian law and seeks options to address these needs specifically.

Overall, I can only congratulate the supervisor and the Faculty. Ms Mastilovic presents a very timely and highly relevant dissertation in which she is asking the right questions and provides valuable and balanced answers with a specific view to the existing Russian law. I can only recommend to accept the dissertation for the purpose of awarding a PhD degree.

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