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The Risk Theory of the Principle of Equality of Creditors

Evgeniy D. Suvorov

Kutafin Moscow State Law University (MSAL), Moscow, Russian Federation

Abstract: The paper is devoted to the nature of bankruptcy law as a mechanism for implementing the principle of equality of creditors. This principle assumes that creditors should bear the risk of insolvency of the debtor. This risk is expressed in the proportion of the claim that turns out to be unsatisfied. Bankruptcy law deals with the distribution of the corresponding risk to creditors of different classes. The essence of the relations of the creditors of an insolvent debtor with each other can be understood through the definition of: 1) the subject in relation to which such relations arise; 2) claims of creditors in respect of this subject matter. The subject of relations of creditors with each other is the bankruptcy estate of the debtor, which (and only which) will be used by each of the creditors to obtain satisfaction. The claim to the insolvent debtor to receive satisfaction under the obligation coexists with the claim to other creditors to receive part of the bankruptcy estate. The right of claim arising from the obligation and addressed to the debtor, in the event of the debtor's insolvency, gives rise to the right to receive part of the bankruptcy estate, addressed to other creditors of the insolvent debtor. However, the lack of the right to claim against the debtor makes the right to a part of the estate addressed to the debtor's creditors impossible.

Keywords: bankruptcy; insolvency; *pari passu*; risk; proportionality; prioritization; segregation; claims; law of obligations

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Contents

I. The Essence and Legal Nature of the Pari Passu Principle

The main principle of bankruptcy law is the principle of equality of creditors, also called the principle of *pari passu*. The existence of the principle is expressly recognized in the doctrine (Shershenevich, 2003, p. 449; Karelina, 2008; Goode, 2011, pp. 89, 99; McBryde et al., 2003, p. 81).

Although the phrase *pari passu* is used not only in bankruptcy law, in general it refers to the idea of equal treatment (Tomsinov, 2008). It should be noted that the phrases *pro rata* and *pari passu*, sometimes used as synonyms in bankruptcy law, are not identical. *Pro rata* is translated as "in proportion" and it denotes the idea of distributing the bankruptcy estate of an insolvent debtor in proportion to the debt in the total debt, which, in turn, is the implementation of the equal approach. Under this approach, *pro rata* is a means to achieve the idea of equality, i.e., the means of implementing the principle of *pari passu*. Thus, we can conclude that *pari passu* is achieved through *pro rata*. At the same

time our thesis is somewhat different from the general approach that identifies the terms *pro rata* and *pari passu* (Bevzenko, 2022, p. 26).

Bankruptcy law owes its existence to the *pari passu* principle. In essence, bankruptcy implies a specific mode of fulfilling the obligations of an insolvent legal subject, i.e., one that, with a high degree of probability, will not be able to fulfill his obligations in full. The essence of the *pari passu* principle is that all creditors of such a debtor, who are in a similar actual situation, should have equal opportunities in terms of obtaining satisfaction from its bankruptcy estate and the implementation of managerial and informational powers accompanying the named goal. Accordingly, if one of the debtor's creditors receives full satisfaction of his claim, he finds himself in a preferential position in relation to other "creditors of the same queue" (*pari passu* creditors), and even more so in relation to unsatisfied creditors in a higher priority position.

Moreover, the creditor finds himself in such a position at the expense of other creditors, if we take into account that the difference between the full satisfaction of his claim and the satisfaction that the mostly satisfied creditor could count on in the proportional distribution of the bankruptcy estate among all creditors, he receives from the bankruptcy estate the funds due to all creditors, and not only to him.

In general, the debtor's creditors facing insolvency are in a similar situation: the very concept of a creditor implies taking the risk of the debtor's insolvency. In this regard, such an attitude towards creditors of the same queue will be equal, when they evenly distribute the risk of insolvency, i.e., assume losses in proportion to the amount of their claims (*pro rata*).

Proportional discharge of creditors' claims is possible only after identifying all the applicants for participation in the distribution of the bankruptcy estate, as well as the formation of the estate itself. Therefore, the insolvency (bankruptcy) legislation introduces an interdiction on individual satisfaction (moratorium), expects creditors to proof and set their claims in a bankruptcy case and ensures settlement with creditors at the same time, taking into account the formed bankruptcy estate. In fact, the paper describes the content of the mechanism for implementing the *pari passu* principle, namely bankruptcy law.

The condition of equal distribution is valid within the same queue, which combines the claims of creditors with similar status (a positive manifestation of the *pari passu* principle). On the contrary, with a significant difference in the status of creditors (also due to the nature of their claims), the named principle requires that these differences should be taken into account by establishing the order of satisfaction, including subordination of claims, or by providing other privileges, including the right to segregated satisfaction (a negative manifestation of the *pari passu* principle).

Regardless of whether bankruptcy will take place under the liquidation or rehabilitation scenario, the *pari passu* principle is valid in all cases, since it does not allow obtaining material, managerial or informational advantages of some creditors over others who are in a similar position to the first.

Significance of the pari passu principle. In the absence of the principle of equality of creditors, the legislation on enforcement proceedings could well cope with the fulfillment of obligations; unknown to creditors and third parties, by *ad hoc* methods.

In turn, it is the *pari passu* principle that makes it necessary to fulfill obligations collectively (immediate in relation to all creditors) and evenly, to carry out liquidation publicly according to the rules of bankruptcy legislation, to take into account the interests of all involved persons, and to retore solvency under control and with the consent of creditors. In particular, it is the need to implement this principle that caused the provisions on the introduction of a moratorium that does not allow individual satisfaction, on the need to include a claim in the register of creditors' claims in order to obtain satisfaction on a collective basis, on a collective method of settlement, on proportional satisfaction in case of insufficiency of funds, on challenging the preferential satisfaction.

The *pari passu* principle in some cases is also considered as the basis for the orderly liquidation of debtors, this is another, but not the main, role of this principle (Zautrennikov, 2019, p. 85).

I.1. Comparative Legal Analysis

Although the principle of equality of creditors in the general provisions of the Russian Bankruptcy Law is not directly enshrined as a principle,[1] it can be derived from Para. 16 Art. 2 of the Bankruptcy Law. The principle of "equality of creditors of the same queue" is also mentioned in a special rule applied in the event of bankruptcy of credit institutions (Para. 14 Art. 189.89 of the Bankruptcy Law). In addition, individual elements (implementation tools) of the principle of equality are contained in the definition of bankruptcy proceedings (Art. 2 of the Bankruptcy Law).

This principle has been repeatedly recognized by the Constitutional Court of the Russian Federation[2] and it is recognized by the Supreme Court of the Russian Federation[3] (e.g., Para. 18 of the Review of Judicial Practice of the Supreme Court of the Russian Federation No. 2 (2017) approved by the Presidium of the Supreme Court of the Russian Federation on 26 April 2017, etc.).[4]

The principle known as "*le principe d'égalité des créanciers*" is recognized in French bankruptcy law. For instance, a moratorium on payments for pre-bankruptcy claims is established from the moment the preservation procedure (*sauvegarde*) is initiated, as outlined in Art. 622-7 of the French Commercial Code.[5] In addition, the distribution of the amount of the debtor's asset among his creditors in proportion

[1] The law does not mention such a principle precisely as a principle, suggesting only a method for its implementation (priority and proportionality).

[2] *See* Ruling of the Constitutional Court of the Russian Federation dated 12 March 2001 No. 4-P "In the case of verifying the constitutionality of the second paragraph of Para. 1 Art. 134 of the Federal Law 'On Insolvency (Bankruptcy)' in connection with the complaint of the public joint-stock company 'T Plus'". (In Russ.).

[3] *See* Para. 52 of the Ruling of the Supreme Court of the Russian Federation dated 21 December 2017 No. 53 "On some issues related to holding persons controlling the debtor liable in bankruptcy". (In Russ.).

[4] *See* Ruling of the Supreme Court of the Russian Federation dated 27 February 2017 No. 301-ES16-16279; Ruling of the Supreme Court of the Russian Federation dated 5 July 2018 No. 301-ES18-114; Ruling of the Higher Court of the Russian Federation dated 16 August 2018 No. 303-ES15-10589 (2); Ruling of the Higher Court of the Russian Federation dated 5 December 2016 No. 305-ES16-10852. (In Russ.).

[5] Code de commerce. 107 ed. Dalloz, 2011, pp. 940–943. (In French).

to the debt (*en proportion de montant*) in the course of judicial liquidation (bankruptcy procedure, liquidation judiciaire) is provided for by Art. 643.8 thereof.[6]

The principle of equality that mandates proportional satisfaction of claims among creditors of the same priority is derived from § 39 of the German Insolvency Code. With regard to § 1 of the Regulation (*par conditio creditorum*), Bork notes that *pari passu* is not only equal, but also the best satisfaction of creditors (Bork, 2017, p. 160).

The principle of equality of creditors is directly enshrined in Art. 2741 of the Italian Civil Code[7] (Guglielmucci, 2017, pp. 9–10).

This principle is also upheld in U.S. bankruptcy law, as indicated by Subsection (b) of Section 726 of the U.S. Bankruptcy Code, which requires that payments for claims in each class be made on a *pro rata basis*[8] (Norton and Norton, 2008, pp. 987, 990–991). The report of the House of Representatives and the Senate notes that the provisions are applicable to cases where the available property (funds) is not enough to satisfy the requirements of one queue (Norton and Norton, 2008, p. 990).

Finch and Milman (UK) point out that the *pari passu* principle is often recognized as the principle playing a fundamental role in corporate bankruptcy law (Finch and Milman, 2017, p. 511; Zwieten, 2019, pp. 121–123, 291; Goode, 2011, p. 235). They also refer to the fact that at present the principle is enshrined in Art. 107 of the Insolvency Act 1986 in relation to voluntary winding up and § 14.12 of the Insolvency Rules 2016 in relation to compulsory winding up and administration (Finch and Milman, 2017, p. 511).

As the authors highlight, *pari passu* provides an orderly means of dealing with unsecured creditors. In their opinion, the named principle,

[6] Le montant de l'actif, distraction faite des frais et dépens de la liquidation judiciaire, des subsides accordés au chef d'entreprise ou aux dirigeants ou à leur famille et des sommes payées aux créanciers privilégiés, est réparti entre tous les créanciers au marc le franc de leurs créances admises (cit. ex Art. L.643-8 CC Code de commerce. 107 ed. P. 1257). (In French).

[7] "I creditori hanno uguale diritto di essere soddisfatti sui beni del debitore" [Creditors have an equal right to satisfaction from the debtor's property].

[8] Payments on claims of a kind specified in paragraph 1, 2... shall be made pro rata among claims of the kind specified in each such particular paragraph.

inter alia, leads to lower costs and shorter delays. It is indicated that the collective model of dealing with unsecured creditors is associated with the *pari passu* principle, which meets the problem of efficiency, since it allows avoiding the costs of individual proceedings (Finch and Milman, 2017, p. 513). The authors also note that the *pari passu* principle is fair both in a procedural and substantive senses, since it prevents individual claims from winning in strength and speed and assumes an equal (equivalent) treatment for all unsecured creditors (Finch and Milman, 2017, p. 513). Goode and Zwieten (UK) emphasize that "the most fundamental principle of bankruptcy law is the distribution of pari passu, all creditors participate in the common pool in proportion to the size of their recognized claims" (Zwieten, 2019, pp. 121–123, 291; Goode, 2011, p. 235).

I.2. Discussion regarding the Existence of the Principle of Equality of Creditors

It is also necessary to appreciate alternative points of view, according to which the principle under consideration does not exist. A prominent proponent of this approach is Mokal who provided his opinion in the paper entitled "Priority as Pathology: The Pari Passu Myth" (Mokal, 2001, p. 581).

As we mentioned above, the collective form of settlement with creditors is a means of equal distribution of risk in pursuance of the principle of equality of creditors. Mokal, on the contrary, sees in the collectivity of the procedure, as opposed to the individual penalty, not a means, but a goal (essence) of bankruptcy procedures. Queues and privileges are secondary issues as compared with the collectivity. In addition, the author argues that creditors' attempts to secure immunity against the collective procedure are suppressed by bankruptcy law. Apparently, this is an objection to the fact that the existence of the principle of equality is confirmed by the recognized possibility to challenge pre-bankruptcy transactions (Mokal, 2001). The author elucidates that *pari passu* puts together similar creditors. But further, he notes, it is the sequence, and not *pari passu*, that ensures the absence of destructive competitions between creditors.

Thus, according to Mokal, the essence of bankruptcy regimes lies in collective production, which streamlines and prevents damage to the general mass. Mokal discovers another advantage of the collective procedure over the individual one: he believes that when the debtor's property as a whole is sold as a "business on the go" (as a going concern), such property can be worth more than if it is sold in parts (Mokal, 2001, p. 592). As a consequence, Mokal believes that the priority and collective nature of the procedure is ensured not by the principle of equality of creditors, but by the key objective. Therefore, bankruptcy law and collectivity are not about equality, but about consistency in order to increase the price of the sale of the debtor's property.

Our disagreement with this position can be expressed as follows. First, the order in which creditors' claims are satisfied is in itself the principle of equality of creditors. Mokal does not take into account the negative manifestation of the principle of equality of creditors when he gives an example of impossibility of challenging on the basis of the provision of preferential satisfaction based on the principle of equality of creditors in the case of equal satisfaction received by creditors of different queues (Mokal, 2001, p. 11).

The collectivity itself, and the author draws attention to this thesis, does not yet give rise to the obligation to act together (Mokal, 2001, p. 592). Collectivity is necessary for equal distribution. Coordinated actions stem from the principle of cooperation, as the interests of one party are interconnected with the actions of others.

Mokal, while justifying the objective of bankruptcy solely by replacing the individual actions of creditors with a collective procedure, which should reduce costs and increase the price of selling the business, comes to a logical for him conclusion: the question of priority within the collective procedure does not matter; it is enough that it be collective (Mokal, 2001, p. 593). It is difficult to agree with such a statement, bearing in mind that the decision on the order is based on the requirement of equality, which, in turn, follows from justice.

Mokal sees the negation of the principle of equality of creditors in the fact that bankruptcy law itself creates exceptions in the form of privileges (Mokal, 2001, p. 582). But after all, this is a confirmation of the principle: they talk about exceptions only in the context of the

rules. The question that the basic solution is precisely equality is not discussed, we are talking about legislative exceptions. The law is needed precisely in order to legitimize such exceptions. In addition, Mokal correctly points out that among preferred creditors the division is also proportional, i.e., equal (Mokal, 2001).

Although Mokal disputes the connection with the principle of equality, it seems that this is another confirmation of this principle: equal to equal, unequal to unequal; those who are unequal can be equal to themselves, and that is where the proportion appears.

It must be admitted that the proportionality of distribution is already a consequence of the principle of equality and it acts only as an instrument within a positive manifestation. Within the negative manifestation, proportionality must be eliminated; this is also a manifestation of the principle of equality. The very "restrictions" to the principle of equality, by virtue of their multitude, blur the idea of equality — this seems to be how Mokal understands the problem when he gives negative manifestations with a reference to Roy Goode (Goode, 1997; Mokal, 2001, pp. 587–588) in the form of secured creditors, suppliers of goods under reservation of title (ROT) clauses, of creditors for whom the debtor "holds" assets by virtue of a trust (Mokal, 2001, p. 585). But looking at this issue as a negative manifestation of the principle of equality allows us to see in these situations its confirmation, not denial.

The approach is interesting: on the example of small and medium-sized businesses author uses and shows their debts statistics (secured creditors, shareholders, finance lease) — all this should, according to the author, show that there is a little place for the *pari passu* principle (Mokal, 2001, pp. 587–588). Our thesis remains unchanged: all of this demonstrates the manifestation of the principle of equality among creditors in a negative context.

Interestingly, Mokal also emphasizes the need to "reprove" exceptions to the principle of equality. It seems that this confirms the author's recognition of the negative manifestations of the principle of equality (Mokal, 2001, p. 590). The principle of equality of creditors is not a myth, just because any exception to it needs to be justified. It is the existence of this principle that serves as the basis for the introduction

of individual exceptions. Otherwise, there would be no concept of an exception, as well as the need to justify each exception.

Finally, this does not exclude, but rather confirms the existence of the principle of equality of creditors, as well as the right to segregated satisfaction of claims from secured creditors. The priority of creditors secured by the debtor's property must be justified by the principle that contrasts the principle of equal treatment, as the notion of a right to a share of the debtor's estate conflicts with the concept of general equality. In this context, all creditors whose claims are secured by various parts of the bankruptcy estate (such as pledged assets or secured items) receive satisfaction in opposition to the principle of equality.

The idea opposed to the principle of equality of creditors is the idea of property rights in that part of the bankruptcy estate that serves the interest of a secured creditor. The key point here is that the person does not bear the risk of the debtor's insolvency while designating (segregating) a portion of the constantly changing estate; in this framework, it cannot be countered by risk-taking.

Possible forms of true and fictitious segregation of assets include pledge agreements, title security, security deposits, set-offs, special accounts, etc. In cases of true segregation, the principle of equality among creditors does not apply to the satisfaction of the asset. Conversely, when segregation is fictitious (sham), we can either discuss the absence of the right to segregation (such as in offset situations) or the negative implications of the principle of equality among creditors (as happens to notary deposits in the event of a bank failure).

II. The Risk Theory of the Principle of Equality of Creditors: Basic Provisions

II.1. Basic Notions: Obligation, Person

Before delving into the theory, it is important to make a few general remarks. Obligation presupposes a claim against a person in civil law. In turn, a person in civil law is a separate property (Sukhanov, 2014; Duvernois, 2004, p. 237). Therefore, an obligation implies a claim to separate property.

At the same time, the obligation does not imply the right to things from personal estate and, moreover, does not create the authority to control debtor's property status. Consequently, the creditor may have a claim to estate that is insufficient for him, as well as to that estate that is insufficient for settlements with all the creditors.

Since each creditor has their own claim to the estate, these creditor-applicants come together, creating the necessary conditions for addressing the issue of how to resolve the competition among creditors. The creditor's claim is nothing but the right to claim. A claim is always addressed to another entity, in contrast to a right to a thing. Under these conditions, this entity may find itself in a situation where it is impossible to fulfill the requirements (requirement) due to the lack of an asset in estate. The need to fulfill an obligation presupposes an answer to the question about the source of such fulfillment. The source of execution is the property of the debtor (estate), which can vary in size at any given time. Consequently, it is fundamentally the creditor's responsibility to bear the risk of an insufficient source of enforcement, which generally does not allow the creditor to seek performance from parties other than the debtor. Thus, creditors bear the risk of their debtor's insolvency by their very status and are not entitled to claim the use of another personal estate to fulfill the obligation.

If the issue of competition is addressed by ensuring equal opportunities for all creditors (or through a combined approach), each creditor (in the same position) will share the same risk, represented by an equal portion of the obligation that remains unfulfilled. This implies an attribute of the right of claim, where all creditors of the same debtor share the same risk of losses due to non-fulfillment, particularly when establishing priority among creditors in the same queue.

From the point of view of fairness, the creditor's bearing the risk of insolvency of his debtor also stems from the fact that the loss in the debtor's business in a competitive environment in most cases is associated with the gain of individual creditors (banks in the form of an interest rate, the budget in the form of taxes, etc.).

Next, we should move on to the issue of competition of creditors as the basis for the collective form of settlements and bankruptcy law in general.

II.2. Creditors' Competition

The subject of competition among creditors is the fulfillment of an obligation to each creditor under conditions where full payment to all is not possible. Such competition can be resolved by establishing the order of discharging the debt, providing equal opportunities for performance (proportional satisfaction), in a combined manner. The order of satisfaction of claims can be established chronologically according to the occurrence of the claim, the size of the claim, the type of claim.

Some queuing methods allow a combined method, when the claims within the same queue are satisfied on the basis of proportionality (equal opportunities), and some other claims are not satisfied. For example, chronological and volumetric modes of satisfaction are not combined with the provision of equal opportunities.

In Russia, as in many other established legal systems, a combined method of claim satisfaction is utilized, where claims are organized in a queue by type, and those within the same queue are satisfied proportionately based on their size relative to the total amount of claims in that queue.

Such a method of discharge is impossible outside the collective form of settlements: proportional satisfaction presupposes the unification of all applicants.

The distribution of the risk of insolvency within one queue of satisfaction occurs on a proportional basis, which, in essence, means that all the creditors of one queue bear equal risk, namely, equal losses in the form of a share of the obligation that turns out to be unfulfilled.

Finally, we shall proceed to the description of risk theory.

The *pari passu* principle is often defined through the proportionate satisfaction of creditors' claims and the right to equal satisfaction from the debtor's estate (Zautrennikov, 2019). This, however, is not entirely true. The creditor's right to claim as a whole follows from his right in relation to the debtor: having the right to the whole, the creditor has the right to the part. First of all, the dissatisfaction of the creditor's claim violates his right in relation to the debtor, and not the principle of equality. Therefore, the principle of equality cannot be elucidated in terms of the amount of satisfaction.

The principle of equality of creditors, meanwhile, is expressed in the fact that creditors do not pretend to receive an equal share of the execution, but to an equal restriction of the right (hence, equal risk). In other words, each creditor has the right to demand that the other creditor assumes the risk of insolvency to the same extent as he does. The risk of insolvency is expressed in the loss of the share of performance due from the debtor. Thus, the violation of the principle of equality means not the smaller claim satisfaction obtained by one creditor (than the debtor owes him), but the bigger claim satisfaction obtained by another creditor who, thus, bears a lower risk of insolvency of the debtor.

Thus, each of the creditors bears the risk of insolvency of his debtor under the obligation, which follows from the essence of the obligation. To clarify the above thesis, let's start with the fact that the creditor has a claim on the person (the right to his action). Consequently, an individual (as defined in civil law) is responsible for fulfilling his obligations with their property (assets). The composition of the property of the debtor (a person in civil law) is dynamic and at each specific point in time can be of a different value, which cannot be ignored by the creditor who has a claim against such a person (but not a real right).

Consequently, the creditor, entering into a binding relationship with the debtor, assumes the risk of such a change in the property status of the debtor, in which the debtor will not have sufficient property to fulfill the obligation to the creditor. Bearing the risk of insolvency of the debtor by the creditor means that the creditor, as a general rule, will not be able to receive satisfaction of his obligation in full if his debtor is unable to fulfill the corresponding obligation. Since the creditor independently bears the corresponding risk, he will not be able to receive such satisfaction by contacting other persons (other property, estate).

The corresponding risk may be realized in the form of full or partial non-fulfillment of the obligation, depending on the solvency of the debtor. Since each creditor bears the risk of default by the debtor of an obligation, in the event of the debtor's insolvency, such a risk can potentially be realized in relation to all creditors. The volume of the obligation not fulfilled as a result to each specific creditor can be

considered the volume of realization of the risk of insolvency of the debtor. The insolvency of the debtor, therefore, may lead to one or another distribution of the risk of such insolvency among creditors: the volume of the defaulted obligation will be the distributed volume of the realized insolvency risk.

In the absence of any restriction, the distribution will be uneven: the first creditors who apply for execution may avoid the risk distribution at all, the next ones may take on a partial realization of it, the rest may take the risk in full. Since the realization of a risk means nothing more than the loss of a part of the creditor's property (estate), it is fair that creditors who are in an equal (similar) position take on the realization of such a risk equally. In turn, equal acceptance of the risk of insolvency means an equal share of the remaining unsatisfied claims of the creditor. This implies that the principle of equal treatment of creditors (principle of equality of creditors, *pari passu* principle) implies an equal distribution of the realized risk of insolvency of the debtor. This also means that each of the creditors must equally lose part of their property (estate) and incur the same share of losses. This is how the implementation of the *pari passu* principle should be understood, bearing in mind that we are talking about equal losses, but not about equal satisfaction (performance).

The latter representation is inaccurate if we take into account the preservation of the debtor's obligation to the creditor in full, regardless of its insolvency: such insolvency does not change the scope of the claim. If the volume of the claim does not change, then all creditors are entitled to full, and not to partial satisfaction. This means that the *pari passu* principle cannot be understood as involving satisfaction in the same parts. Although this distinction seems insignificant, it makes clear the essence of the principle: the losses from the realized risk of insolvency are equally distributed. Of course, an equal distribution of the realized risk of insolvency is necessary among equal creditors. If there are differences in the position of the creditor, which are important for granting him a privilege (higher priority) or for his discrimination (subordination of the claim), the risk to be distributed must take this into account.

In itself, the increase in the order of satisfaction of the claim means a decrease in the risk of insolvency distributed to creditors of the corresponding queue, subordination means an increase in such risk. Please note that in these cases we are talking about the distributed potential risk, and not about the distribution of realized risk (losses). In particular, if the debtor does not have sufficient funds to satisfy the claims of priority creditors, such creditors assume a reduced risk (probability of loss), however, this risk is realized in full or in part of the loss. Lower-ranking creditors, although they take on an increased risk, it may turn out to be realized in the same number of losses as those of higher-ranking creditors: this will take place when the debtor, in principle, does not have the any estate to partially satisfy the claims of creditors above standing queue. Thus, the *pari passu* principle implies a uniform distribution of realized risk (losses) among creditors of the same queue and may imply a different distribution of risk among creditors of different queues. It follows that the principle of equality of creditors cannot provide a different distribution of the realized risk of insolvency, but it can provide a different distribution of the risk of insolvency among creditors of different queues and an equal distribution of the realized risk among creditors of the same queue.

II.3. The Notion of Creditor and Creditors' Risks

The very concept of a creditor (it. *credere* — to believe) comes from the concept of trust. In turn, in civil circulation, everyone trusts not so much persons as their property masses (estate), since the subject in civil law is an estate around which debts (liabilities) are concentrated (Sukhanov, 2014; Duvernois, 2004, p. 237). For example, the principle of limited liability follows from the principle of independence of subjects of civil law. If so, then the creditor claims such estate. It is fair that creditors claim as much as they contributed to the mass (estate). At the same time, the contribution to the estate is the provision that the creditor made. That is why the creditor assumes the risk of non-satisfaction of the debt to the same extent as everyone else, but in absolute terms, the amount of losses will always depend on the amount of contribution to the debtors' estate.

Thus, the risk of insolvency of the debtor lies with the creditor who trusted the person. Since trust is given to a person where there are no guarantees regarding the composition and volume of the property mass (estate) of this person, the creditor bears the risk of the debtor's insolvency. The risk of insolvency of the debtor is manifested in the actual (non-legal) impossibility to satisfy the claim. The actual impossibility of satisfying the claim may be complete or partial. The distribution of the risk of insolvency means, therefore, the distribution among creditors of a certain part of the remaining unsatisfied due to the actual impossibility of claiming.

The general rules for risk distribution in private law assume that the owner of a particular good (thing, right) bears the risk of losing this good on his own. The assignment of risk to the owner of an object of civil law is based, in turn, on the ability and interest of just such an owner to take measures to reduce this risk.

In Russian Federation, the general corresponding maxim is expressed in Art. 211 of the Civil Code of the Russian Federation,[9] by virtue of which the risk of accidental loss or accidental damage to property is borne by the owner, unless otherwise provided by law or contract. It seems that such a rule expresses a general idea and can be extrapolated beyond the limits of real legal relations. In the same way, the risk must be borne by the owner of other objects of civil law: the claim, the intellectual property. Such an extension of the idea beyond the real right is motivated by the absence of fundamental differences in the legal status of the owner of the thing and the owner of the claim. Although there is certainly a specificity, the owner of the claim, just like the owner, (1) is interested in preserving the good, (2) has the greatest amount of opportunities to preserve it as compared to other persons.

Thus, the creditor, like the owner of the thing, is interested in the possibility of exercising the right of claim, as well as having more opportunities for this than others: to analyze the solvency of the debtor before entering into a relationship (for voluntary creditors), to seek security, to take timely measures of operational protection, etc. Of

[9] Civil Code of the Russian Federation (Part I) dated 30 November 1994 No. 51-FZ (as amended on 16 April 2022). *Collection of Legislation of the Russian Federation*. 1994. No. 32. Art. 3301.

course, all these possibilities do not guarantee the elimination of the risk of non-fulfillment of the claim due to the insolvency of the debtor, but this is not the main thing: it is important that there are a priori more of these possibilities than anyone else, and therefore the risk is not even potentially can be transferred to someone on the basis of his privileged (in relation to the possibility of avoiding the risk of insolvency of the debtor) position.

It should be recognized that the risk of insolvency of the debtor, like any risk, is not legal. It is precisely the transfer (distribution) of this risk that relates to matters of law. If the law is silent on the issue of risk distribution, then the general rule described above applies: the risk is borne by the owner of the corresponding good. It follows that the corresponding risk, contrary to the general rule of law, can be transferred to another person. Risk transfer is the responsibility of adverse consequences of the realization of the risk on a person other than the owner of the lost good.

In case of risk transfer, losses incurred in the property of the owner of the lost good are compensated to such owner by the person to whom the corresponding risk was transferred. With regard to the transfer of the risk of insolvency of the debtor, this will be expressed in compensation to the creditor for losses in the amount of lost satisfaction. The most well-known form of transferring the risk of insolvency of the debtor is vicarious liability for the obligations of such a debtor to third parties (currently regulated in the Russian Federation in Chapter 3.2 of the Bankruptcy Law).

II.4. Instability of the Ratio of Debtor's Obligations and Debtor's Estate as a Reason of Creditor's Risks

As already mentioned, the risk of the debtor's insolvency is associated with the principles of independence and limited liability: it is the impossibility of turning to other persons (their estates) that entails the potential impossibility of satisfying all creditors from the debtor's estate. This impossibility is associated with the absence of any correlation whatsoever between the volume of obligations (liabilities) of the debtor and the value of his property (assets). So, in relation to a

liability, the debtor is free to enter into any obligations, regardless of the fact that this may lead to an excess of the liability over the asset. In addition, the debtor may become the subject of an involuntary obligation (delict, unjust enrichment).

As for the asset, the debtor's property may be spent or destroyed (perish), damaged, and finally, the value of such property may change for the worse for the debtor.

The whole set of circumstances leads to the conclusion that, at any particular moment in time, there can be any ratio of the obligations and property of the debtor, including one in which all the property is not enough to satisfy all obligations. The principle of independent responsibility means that the debtor's obligations, however, can only be fulfilled at the expense of the debtor's property (Art. 24, Clause 1, Art. 56 of the Civil Code of the Russian Federation) and the creditor cannot turn to other persons (other property masses, estates) for discharging debtor's obligations.

II.5. The Principles of Limited Liability and of Independent Liability as a Legal Basis of Creditors' Risks. The Risks' Distribution Role of Bankruptcy Law

The principle of limited liability, arising from the principle of independent liability, means that the creditor cannot apply to persons who have combined their capital or their efforts to form the debtor as a legal person; the named persons are liable within the limits of the contributions they have already made (there is no such liability when combining persons) (Clause 2, Art. 56 of the Civil Code of the Russian Federation), i.e., owe nothing to the debtor's creditors.

In some cases, it is allowed to mix the principles of independent and limited liability, which is not justifiable: the latter is only a variation of the former in relation to legal entities, for whose obligations the founders are not liable. In other words, among all the persons who are protected by the principle of independent liability from other people's obligations, the principle of limited liability specifically singles out the founders of the corresponding debtor: they are not liable for its obligations, being other subjects of civil law. Such a specification of a

general decision is caused by the presence in the legal order of legal entities, for whose obligations the respective founders are still liable (Para. 2, Clause 1, Art. 56 of the Civil Code of the Russian Federation).

The connection of the risk of insolvency with the principles of independent and limited liability in relation to the rules for the distribution of this risk in accordance with the *pari passu* principle leads to the conclusion that the *pari passu* principle is to a certain extent dependent on the principles of independent and limited liability. This, in turn, means that where these principles do not apply, there will be no place for the *pari passu* principle: the unsatisfied part of the claim from the bankruptcy estate of the debtor will be satisfied at the expense of the estates of other persons. And only in the case when, due to a shortage of funds to satisfy the claims from the named estates, creditors will not be able to turn to other persons due to the principle of independent responsibility, the *pari passu* principle will begin to operate. True, this will take place in relation to the estate of the subsidiary responding debtor.

The option that the *pari passu* principle is a consequence of the idea that creditors accept the risk of non-payment from the debtor and distribute such risk is not an alternative to the nature of such a principle as a special case of the general principle of equality. As can be seen from the above, equal acceptance of the risk of insolvency corresponds to the general idea of equality of equals, which, in turn, is based on the concept of justice.

In view of the foregoing, it turns out that bankruptcy law is a regulator of the distribution of risk, which is fully manifested in bankruptcy: from eternal debt in the ancient period (Shershenevich, 2003, p. 102) (in case of non-exemption from debts, or even quartering of debtor for division between creditors) (Shershenevich, 2003, p. 102) to repayment of debts under proceedings in the present time.

Interestingly, we find the same thought in K. van Zwieten arguing, that “This principle is based on the notion that unsecured creditors should bear losses equally: as the Supreme Court recently stated, apportionment provisions embody ‘fundamental principle of equality’” (Zwieten, 2019, p. 292).

It turns out that equality consists not so much in distribution as in incurring losses, while the right to control (votes) is also granted for the future incurring of losses. The Report of the Institute of European Law states the same: the insolvency of an enterprise is a situation in which losses must be distributed between creditors and interested parties.[10]

Attention should also be paid to the fact that creditors in bankruptcy in absolute terms receive unequal satisfaction (at the face value of the property provided by the debtor), which may raise the question of why creditors are said to be equal. The answer to this question lies in the risk theory described above: the risk of insolvency is expressed in the share of the requirement remaining unsatisfied, such a share is the same for equals, therefore and only because of this, it is a question of the principle of equality (*pari passu*), and not of proportionality (the mechanism of equal distribution of risk is *pro rata*).

In other words, the risk of insolvency is equally distributed, not the property of the debtor. In turn, the creditor is entitled to the same share of satisfaction, which is inversely proportional to the same share of risk. Since the right to satisfaction for him does not follow from the *pari passu* principle, but from the principle of due performance, the only way the *pari passu* principle can be understood is the equal distribution of risk (such risk is an input condition that stops the action due performance principle). At the same time, equal distribution (the absolute amount of satisfaction), on the contrary, would violate such equality, since it would not take into account the degree of risk of each of the creditors. Further, it is the degree of risk (losses in absolute terms) that determines the level of control in the bankruptcy case and the level of participation in the distribution.

II.6. The Implementation of the Pari Passu Principle and its Stages

The implementation of the *pari passu* principle through the distribution of risk may have final and intermediate stages. The last stage in the distribution of the risk of insolvency is the repayment of the

[10] Rescue of Business in Insolvency Law, (2017). European Law Institute. 2017. P. 255. Para. 442. Available at: https://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf [Accessed 05.03.2025].

remaining unfulfilled part of the obligation. Meanwhile, in the case of forced debt reduction or forced deferral of its execution in rehabilitation procedures (debt restructuring), the imposition of a reorganization plan (cramdown) is a way of distributing the risk of insolvency. New conditions can be imposed on the creditor precisely because he is the bearer of the risk of impossibility to fulfill the previous conditions of the obligation.

In general, the risk theory proceeds from the fact that each of the creditors owns the risk of insolvency of his debtor, as the owner owns the risk of destruction of his property. Such a risk can be transferred to third parties only on special grounds for this: on a subsidiary (vicarious) debtor — when bringing to bankruptcy or misleading; on guarantor; for a subsidiary (vicarious) debtor for a special subject of civil law (state-owned unitary enterprises, public offices).

As stated above, the risk of the debtor's insolvency lies with the creditor as the owner of the subjective right (claim). The term *"owner"* of a subjective right follows from the construction of "right to right", previously substantiated in the doctrine (Vasilevskaya, 2004, p. 99), and serves to designate that characteristic for the legal subject (legal person), which allows us to consider a subjective right as a type of an object of law (property right), and its subject — having the authority to dispose of the relevant subjective right (Tretyakov, 2022). In other words, in this way the creditor's ownership of a separate object of law is justified — a subjective right, the risks of "loss" of the useful properties of which, as a general rule, are borne by the subject of the relevant right (by analogy with the position of the owner in relation to risk of accidental loss or accidental damage to things).

In turn, the bankruptcy of the debtor under the obligation changes the term and method of satisfying the subjective right (claim). Now the method becomes collective, assuming order and equality within the queue. Since equality consists in the same share of the risk of non-payment for each of the equal subjects, such a risk is realized by non-payment of that part of the debt that is equal to the level of risk for the corresponding category. It should be recognized that creditors have different queues of satisfaction there are several levels of risk, such levels can be called the degree of risk. The higher the satisfaction

queue, the lower the level (degree) of risk. For example, the first order of satisfaction corresponds to the risk of the first degree, the second order of satisfaction corresponds to the risk of the second degree, etc.

It must also be recognized that the exclusion from the definition of the proportion for the equal distribution of the risk of the amounts of penalties and financial sanctions confirms that the *pari passu* principle follows from the equal distribution of risk. Such a risk manifests itself in the losses of the creditor, which are fully represented by the principal, and not additional (without consideration) claim. Of course, an objection about the losses' nature of the penalty is possible here, but it must be recognized that, being separated from its basis, the penalty became an additional and non-loss claim. Therefore, both the right to satisfaction (proportional within the framework of the collective calculation) and the right to control are based on the amount of real damage.

It is more accurate to call the *pari passu* principle the principle of equal treatment, which emphasizes the equality of legal approaches. If we talk about the mechanism of law, then we are talking about equality of opportunities, duties and prohibitions. As follows from the above, the principle of equal treatment of creditors is incorrectly understood as equality of opportunities (rights) for satisfaction, since each creditor already has the right, the satisfaction of which he is asking for. Therefore, it is necessary to talk about equality in the restriction of rights, which consists in taking on the risk of default by the debtor. It would be correct to say that we are dealing with an equal termination of the right, since the right with the calculation according to the general rule is terminated by the inability to fulfill the obligation. An exception, however, includes cases where the right can still be exercised at the expense of other people's property masses (estates) or withdrawn property (for example, Clause 11, Art. 142 of the Bankruptcy Law).[11]

However, involuntary creditors (victims of tort and unjust enrichment claims) also have a claim to the person, therefore, they bear the risk of insolvency.

[11] The legal regime of retired things (Clause 11 Art. 142 of the Bankruptcy Law) is as follows: these are things that do not belong to the owner (illegal basis for disposal), but no longer have an owner (with liquidation the subject of law ceased to exist).

Thus, bankruptcy law aims to ensure the *pari passu* principle, i.e., distribute the risk of insolvency of the debtor equally (in negative and positive manifestations of such the principle). Reducing and increasing the corresponding risk is possible within the framework of the negative manifestation of the *pari passu* principle.

The fairness of the distribution of risk implies, however, such a distribution on the one who accepted it (the creditor trusts the person, and therefore accepts the risk of its insolvency). At the same time, the refusal to accept risk is manifested in property security when the pledgee accepts the risk of loss or damage to the thing that constitutes the security.

The risk theory of bankruptcy assumes development in the economic context: for example, an option (derivative) can be bought for such risks, such risks can be insured. Bankruptcy and satisfaction statistics seem to be the material for determining the probability of the realization of the risk of insolvency.

II.7. Creditor's Right in relation to the Equal Distribution of Risk

Next, it should be established what right each of the creditors has in relation to the equal distribution of risk and the equal distribution of realized risk (losses) in relation to creditors in a similar position. In particular, it is necessary to determine whether the requirement of equality in terms of the distribution of risk and losses constitutes the content of the subjective right of obligation in relation to the debtor or has a different essence. The requirement for equal bearing of risk and losses as a realized risk is addressed not to the debtor, but to other creditors of the debtor. There are other creditors who must be in the same position as the subject of the corresponding claim. Receipt by the creditor of fulfillment in an amount greater than the creditor of his queue will receive constitutes a violation of the principle of equal distribution of the risk of insolvency and losses from the realization of such risk. Consequently, all creditors of the debtor will be obligated persons in relation to the requirement of equality of creditors. It follows from this

that the corresponding subjective claim constitutes the content of legal relations between creditors, but not between a creditor and a debtor. One should take into account the main details of the nature of these legal relations, their subject composition, the content of the rights and obligations of creditors in them.

Thus, the creditor's right to the debtor's action (obligation) includes the following legal possibilities: the right to demand performance; the power of judicial protection, which breaks down into the right to sue and the power to initiate and participate in a collective bankruptcy procedure. In addition, the creditor has the right to dispose of the claim (assign, pledge, contribute it to capital), as well as the right to refuse the same claim.

Meanwhile, the subjective right of the creditor does not include the right to demand an equal distribution of the risk of impossibility of performance by the debtor, since the debtor himself in the majority of cases does not distribute the debtor's estate, which is done by the insolvency practitioner. In addition, the debtor is in principle indifferent to what share this or that creditor will be satisfied with, such a debtor has absolutely no interest in the amount of satisfaction of individual creditors. Such an interest is a prerequisite for determining the subjects of the relevant legal relationship: it is precisely the need to resolve clashing interests that brings to life the norm that defines the boundaries of the subjective right of everyone. In particular, here we fully agree with R. Iering, who believed that subjective right is "interests protected by law "[den rechtlich geschützte Interessen] (Ihering, 1880, p. 72).

The interest is not with the debtor, but with the same (other) creditors of this debtor. It is the volume of satisfaction of each of the creditors that depends on the extent to which such satisfaction will be received by other creditors. This feature of the conflict of interests is connected with the fact that we are talking about an insufficient object for division between all creditors: with such a lack of satisfaction, the share of satisfaction of one depends inversely on the share of satisfaction of the other.

III. Conclusion

The creditor has the right to demand equal satisfaction and, consequently, equal distribution of risk in relation to other creditors — interested subjects. It turns out that we are talking about the right that is included in the subjective right of each of the creditors in relation to each other, and not about the subjective right of the creditor in relation to the debtor. In this regard, the *pari passu* principle is not the principle of exercising the obligatory right of the creditor to the debtor.

If the right to demand equal distribution of risk is the right of the creditor in relation to other creditors, it is necessary to establish the essence of the relations of creditors with each other, determine their legal nature, identify the specifics, areas of intersection of interests and potential rules governing these conflicts.

The essence of the relations of the creditors of an insolvent debtor with each other can be understood through the definition of: 1) the subject in relation to which such relations arise; 2) claims of creditors in respect of this subject matter.

The subject of relations of creditors with each other is the bankruptcy estate of the debtor, which (and only which) will be used by each of the creditors to obtain satisfaction for their claim.

In turn, the claim of each of the creditors is to receive satisfaction from the bankruptcy estate.

As can be seen, here the claim to the insolvent debtor to receive satisfaction under the obligation coexists with the claim to other creditors to receive part of the bankruptcy estate. It turns out that the right of claim arising from the obligation and addressed to the debtor, in the event of the debtor's insolvency, gives rise to the right to receive part of the bankruptcy estate, addressed to other creditors of the insolvent debtor.

Thus, the reverse conclusion can be made. The absence of the right to claim against the debtor makes impossible the right to a part of the debtors' estate addressed to the community of the debtor's creditors. Consequently, being in the register of creditors' claims itself, if it is associated with the absence of a liability claim against the debtor, does not indicate the existence of a right to a part of the debtor's estate that is opposed to other creditors of the insolvent debtor.

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Information about the Author

Evgeniy D. Suvorov, Dr. Sci. (Law), Professor, Department of Civil Law, Kutafin Moscow State Law University (MSAL), Attorney, Moscow, Russian Federation
edsuvorov@gmail.com
ORCID: 0009-0001-7472-9553