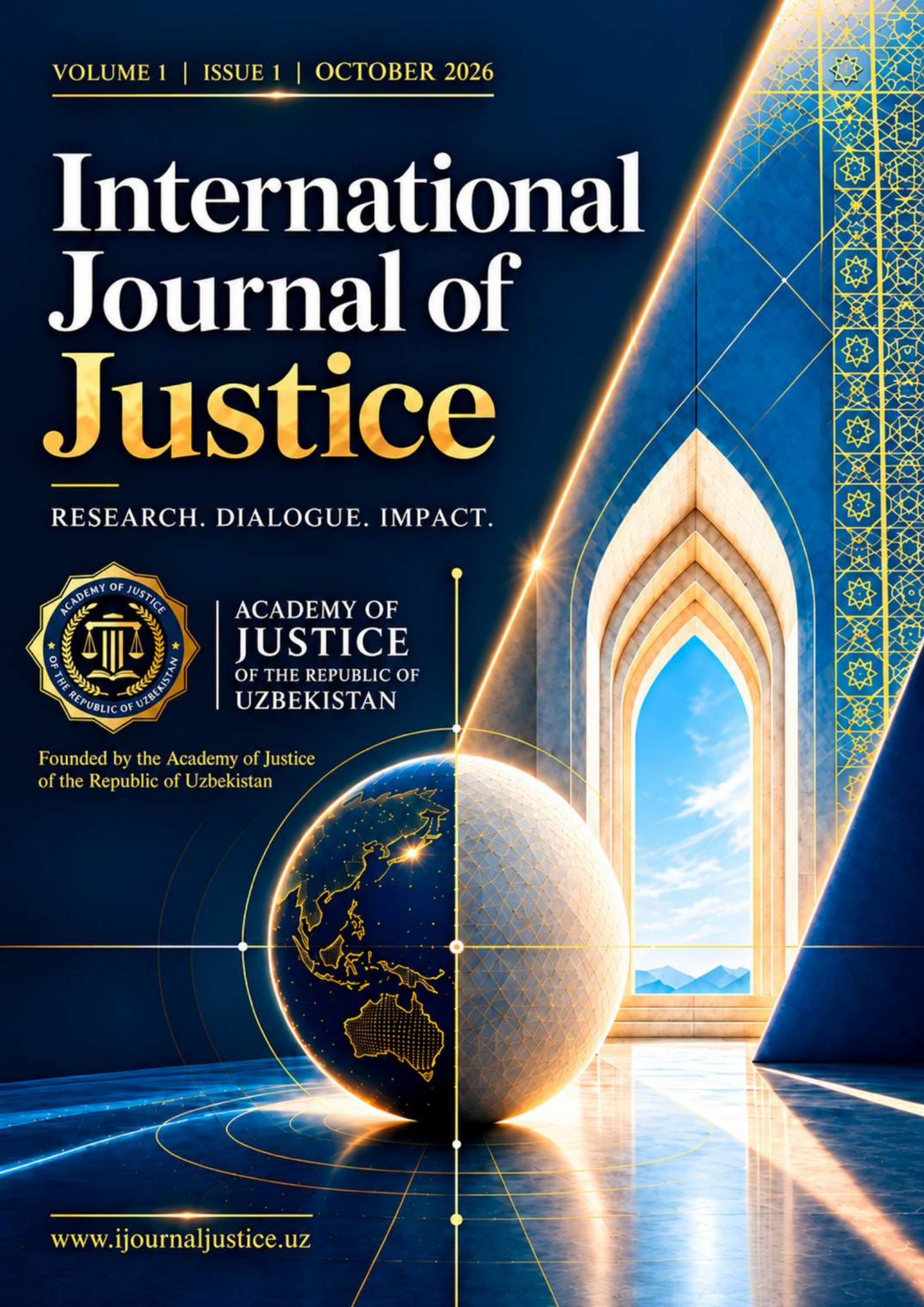
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THE LEGAL NATURE OF SUBSIDIARY LIABILITY IN INSOLVENCY PROCEEDINGS INVOLVING AGRICULTURAL BUSINESS ENTITIES

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Abstract. *This article provides a comprehensive analysis of the legal nature and practical application of the subsidiary liability of persons controlling agricultural business entities in insolvency proceedings. The study examines inconsistencies between the provisions of the Civil Code and the Law of the Republic of Uzbekistan "On Insolvency", as well as factors arising from the seasonal nature of agricultural production and the specific characteristics of biological assets. Based on the findings, the article advances an original doctrinal concept and a set of scientific and practical proposals aimed at reconsidering the requirement of establishing the relevant circumstances by a court decision and defining the complex legal nature of subsidiary liability as combining tortious and additional property liability.*

Keywords: *Insolvency, subsidiary liability, agricultural business entities, controlling persons, agricultural clusters, creditors' rights, corporate governance, standards of good faith and reasonableness.*

Effective protection of creditors' proprietary rights is one of the fundamental objectives of modern insolvency law. Where the assets of an insolvent debtor are insufficient to satisfy creditors' claims, the principle of the separate property liability of a legal entity may create a risk that persons who have exercised decisive influence over the debtor's activities evade personal liability for conduct that has contributed to the debtor's insolvency. Consequently, the institution of subsidiary liability has evolved as an important legal mechanism for reconciling the principle of the legal entity's separate legal personality with the requirements of good faith, creditor protection, and responsible corporate governance.

These problematic issues become particularly relevant in the context of agricultural business entities. Insolvency of agricultural business entities and the resulting failure to satisfy creditors' claims may not only infringe upon their proprietary interests but also undermine the principles of trust, good faith, and property liability underlying civil transactions. In particular, where the debtor's assets are insufficient to satisfy creditors' claims, the institution of subsidiary liability assumes particular importance as an effective legal mechanism for protecting creditors' rights [1]. Agricultural business entities operate under economic conditions that differ significantly from those of many other commercial sectors. Their financial condition may depend on the seasonal nature of production, climatic conditions, the biological characteristics of agricultural assets, state subsidies, preferential financing, agricultural clusters, cooperatives, as well as extended production and investment cycles.

Accordingly, insolvency in the agricultural sector may arise not only from managerial

errors or misconduct but also from objectively adverse economic conditions. This distinction is of fundamental importance when determining whether subsidiary liability should be imposed. The mere fact that an agricultural business entity has become insolvent cannot, in itself, constitute grounds for automatically imposing the debtor's obligations on its founders, managers, owners, or other controlling persons. At the same time, sector-specific economic risks must not become a means of concealing intentional or negligent conduct that has caused substantial harm to creditors.

Pursuant to Article 329 of the Civil Code [2], subsidiary liability constitutes additional property liability that arises only where the principal debtor fails to perform its obligation. Its legal essence lies in the requirement that the creditor must first assert a claim against the principal debtor, and only if such claim remains unsatisfied or is not performed within a reasonable period does the right arise to bring a claim against the person bearing subsidiary liability. In insolvency relations, however, once the debtor has been declared insolvent and liquidation proceedings have been initiated, authorized persons and the insolvency administrator are entitled to apply to the court for the imposition of subsidiary liability (Article 71 of the Law of the Republic of Uzbekistan "On Insolvency").

As noted in the scholarly literature [3], subsidiary liability does not replace the principal liability but supplements it; therefore, it arises only when it is established that performance of the principal debtor's obligation is impossible or ineffective. Accordingly, subsidiary liability does not constitute an independent obligation but rather represents additional civil liability arising from the failure to perform the principal obligation. Its legal nature is manifested not in substituting for the principal obligation, but in serving as an additional legal safeguard aimed at ensuring the rights and legitimate interests of creditors.

This regulatory framework raises an important theoretical question: should subsidiary liability in insolvency proceedings be understood as a specific form of the general civil-law institution of subsidiary liability, or should it be recognized as an independent institution of insolvency law with its own legal grounds, functions, evidentiary framework, and procedural mechanisms?

The significance of subsidiary liability is particularly pronounced in insolvency relations, especially in the context of the insolvency of agricultural business entities. This is primarily attributable to the widespread use of state subsidies, preferential lending, agricultural clusters, cooperative arrangements, and seasonal production processes in the agricultural sector. In this context, the debtor's bad-faith conduct may adversely affect not only creditors but also the interests associated with public funds, state support programs, and other participants in economic relations.

Accordingly, subsidiary liability in insolvency law should not be regarded merely as a form of additional liability. Rather, it constitutes a specialized legal institution designed to ensure effective protection of creditors' rights, preserve the insolvency estate, promote good faith in corporate governance, and safeguard the stability of economic relations. As scholars of legal practice have emphasized, the modern institution of civil liability performs not only a compensatory function but also preventive, regulatory, and law-educational functions.

From this perspective, subsidiary liability in insolvency relations serves not only as a means of satisfying creditors' claims but also as a legal mechanism encouraging persons who effectively control the activities of a legal entity to act in good faith and with due diligence. This, in turn, necessitates assessing the legal nature of subsidiary liability beyond the framework of the general civil-law institution and recognizing it as an independent and distinctive institution of insolvency law.

This study substantiates the view that the second approach is more consistent with contemporary trends in the development of insolvency law. Although subsidiary liability retains its characteristic ancillary nature as an institution of civil law, its application in insolvency proceedings is based on a substantially different legal framework. In particular, the decisive issue is not merely the debtor's failure to perform its obligations, but the existence of a legally significant causal connection between the conduct of the controlling person, the deterioration of the debtor's financial condition, and the loss of the possibility of satisfying creditors' claims.

Accordingly, the purpose of this study is to elucidate the theoretical essence of subsidiary liability in insolvency proceedings involving agricultural business entities and, through a comparative analysis of selected CIS legal systems, to identify directions for improving the legislation of Uzbekistan.

In the course of the study, the legislation of the Republic of Uzbekistan governing civil liability and insolvency, as well as established scholarly and doctrinal approaches developed by legal scholars in the CIS countries, were examined. Several complementary methodological approaches were employed.

The scholarly literature reveals the absence of a unified approach to the legal nature and substantive content of subsidiary liability within insolvency relations. In particular, V. N. Alferov approaches subsidiary liability as an economic and legal category, associating it with the bad-faith conduct of persons controlling the debtor, that is, conduct contrary to the principles of good faith, which has resulted in the debtor's insolvency [4]. Legal scholar K. I. Evteev, by contrast, characterizes subsidiary liability as liability of a tortious nature. In his view, such liability may arise where the debtor's assets are insufficient to satisfy creditors' claims and the improper conduct of controlling persons has caused the debtor's insolvency [5].

Emphasizing that subsidiary liability is aimed at protecting the proprietary interests of creditors, Yu. S. Bespalov notes that its principal function is to secure the creditor's unsatisfied property claim through the assets of an additional liable person [6]. B. M. Gongalo, in turn, regards subsidiary liability as an additional legal mechanism that arises alongside the liability of the principal debtor [7].

Legal scholarship also identifies as a distinctive feature of this institution the requirement that, before bringing a claim against a person bearing subsidiary liability, the creditor must first demand performance of the obligation from the principal debtor. Subsidiary liability arises only where such demand remains unsatisfied or performance by the principal debtor is impossible [8].

In our view, these approaches are not mutually exclusive; rather, they reflect different legal dimensions of the institution of subsidiary liability. On the one hand, the unlawful and culpable conduct (or omission) of

the controlling person is of decisive importance for the emergence of such liability. On the other hand, its principal function is to restore the "property balance" by covering creditors' unsatisfied claims where the debtor's assets are insufficient to satisfy them.

Under general civil law, subsidiary liability traditionally has an ancillary character. The creditor must first demand performance of the obligation from the principal debtor and may only subsequently bring a claim against the person bearing subsidiary liability if the principal obligation remains unperformed. From this perspective, subsidiary liability does not replace the principal obligation but, rather, creates an additional source for satisfying the creditor's claim.

However, in insolvency relations, the practical and legal substance of this mechanism changes considerably. Where the debtor's assets are insufficient to satisfy creditors' claims, the principal legal issue is not merely the debtor's failure to perform its obligations. Rather, the central question is whether such insufficiency has resulted from, or has been materially aggravated by, the conduct of a person exercising control over the debtor.

Accordingly, subsidiary liability in insolvency proceedings encompasses, at a minimum, the following interrelated elements: first, the existence of the debtor's insolvency; second, the existence of a person who exercises actual or legally recognized control over the debtor; third, the existence of unlawful or culpable conduct attributable to such person; and fourth, a causal link between such conduct and the loss of the possibility of satisfying creditors' claims.

This structure demonstrates that subsidiary liability in the context of insolvency possesses distinctive features that cannot be fully explained by the traditional civil-law model of subsidiary liability.

At the same time, it would also be theoretically inaccurate to characterize it exclusively as tort liability. While its compensatory function is intrinsically linked to the ancillary nature of liability, its preventive function is associated with the legal regulation of corporate governance and the conduct of controlling persons. Therefore, the most appropriate approach is to recognize subsidiary liability as a specialized civil-law institution within insolvency law. It constitutes a legally established exception to the principle of the separate property liability of a legal entity and applies where the conduct of a controlling person has caused the debtor to become unable to perform its obligations to creditors.

This approach also makes it possible to distinguish subsidiary liability from ordinary liability for damages. The object of subsidiary liability is not limited to compensation for loss caused by an individual civil-law violation. Its broader purpose is to restore the possibility of satisfying creditors' claims where the insolvency estate has become insufficient as a result of the conduct of a controlling person.

The legal grounds for subsidiary liability may, from a theoretical perspective, be classified into three principal categories: statutory, contractual, and tortious grounds.

A statutory ground derives directly from legal provisions establishing the liability of controlling persons in insolvency proceedings. A contractual ground may arise where a person assumes additional liability pursuant to a contract concluded in accordance with the law. Such liability, however, must not conflict with the mandatory provisions governing insolvency. A tortious ground arises where

unlawful conduct causes damage to creditors or contributes to the debtor's insolvency.

In contemporary civil-law doctrine, the legal grounds for subsidiary liability are interpreted more broadly. It has been emphasized that such liability is not limited exclusively to contractual or tortious grounds but is also closely connected with corporate relations through the rules established in the constituent documents (charter) governing the activities of a legal entity [9].

However, in our view, recognizing constituent documents (the charter) as an independent legal source of subsidiary liability is theoretically debatable. A charter does not, in itself, give rise to civil liability; rather, it constitutes an internal corporate instrument that specifies the content and scope of corporate obligations established by law. Therefore, a breach of the charter's provisions should not be regarded as an independent ground for subsidiary liability but rather as an additional legal fact capable of giving rise to liability based on statutory or tortious grounds.

From this perspective, it is appropriate to systematize the legal grounds for subsidiary liability in insolvency relations involving agricultural business entities. These grounds should be defined as arising from statutory provisions, contracts, and tortious conduct, while constituent documents should be regarded as a corporate-law criterion facilitating the implementation of such grounds. Such an approach is both doctrinally and practically justified.

The Law of the Republic of Uzbekistan "On Insolvency" establishes a special legal mechanism for imposing subsidiary liability. Article 69 of the Law defines a person controlling the debtor's affairs, including a person who has the right to issue binding instructions, the ability to determine the debtor's activities, in certain circumstances owns more than half of the debtor's charter capital, or has the authority to appoint or elect the head of the debtor.

Article 70 establishes the substantive legal grounds for subsidiary liability. Where the insolvency of a legal entity has resulted from the unlawful actions of a person entitled to issue binding instructions, the owner of the legal entity's property, or another person controlling the debtor's affairs, and the debtor's assets are insufficient to satisfy creditors' claims, such person may be held subsidiarily liable.

This provision combines two elements that are often considered separately in legal doctrine: the ancillary nature of liability and the unlawful conduct of the controlling person. Therefore, the Uzbek model can be regarded as neither a fully classical model nor a purely tort-based model. Rather, it represents a hybrid legal mechanism in which the insufficiency of the debtor's assets creates the need for an additional claim, while the unlawful conduct of the controlling person constitutes the substantive legal basis for imposing the obligation on that person.

The insolvency legislation of the Russian Federation provides a comparatively developed mechanism for regulating the liability of controlling persons. Under the Federal Law of the Russian Federation "On Insolvency (Bankruptcy)," a controlling person may be held subsidiarily liable where, as a result of that person's actions or omissions, it becomes impossible to fully satisfy creditors' claims. The legislation also establishes presumptions relating to transactions causing substantial harm to creditors, the absence or

distortion of accounting records, and certain forms of unlawful conduct.

This approach is of particular theoretical significance because it shifts the focus from the formal existence of control to the economic consequences of the conduct of the controlling person.

Russian legislation also provides a controlling person with the possibility of avoiding liability by demonstrating the absence of fault, in particular by proving that he or she acted reasonably and in good faith under the ordinary conditions of civil transactions, acted in the interests of the debtor, and did not violate the proprietary rights of creditors. Thus, this model reflects a more differentiated approach to the allocation of the burden of proof.

In our view, this approach is particularly important in the context of agricultural insolvency. Agricultural enterprises may become insolvent as a result of droughts, excessive rainfall, crop diseases, livestock losses, market fluctuations, export restrictions, or other objective and unforeseeable circumstances. Such factors should not, in themselves, automatically result in the imposition of subsidiary liability on managers or owners.

One of the most important theoretical and procedural issues concerns the evidentiary significance of establishing unlawful conduct in a prior judicial decision. A court finding that a transaction is invalid, a judicial determination of fraud or intentional insolvency, or the judicial establishment of another unlawful act may constitute important evidence of unlawful conduct. However, treating the prior judicial establishment of such circumstances in every case as an absolute procedural prerequisite for imposing or determining subsidiary liability may result in unnecessary duplication of proceedings.

At the same time, this issue must be approached with due caution. Procedural simplification should not undermine the right of the person subject to liability to defend themselves or deprive the controlling person of the opportunity to present evidence demonstrating the absence of fault or a causal connection between their conduct and the debtor's insolvency.

As legal scholar U. Kholmirzaev has rightly noted, the unlawful conduct of a participant itself may be sufficient to cause a legal entity to become insolvent, whereas requiring intent or other additional mandatory elements is inconsistent with the legal nature of subsidiary liability [10]. In practice, such an approach requires the fact of the unlawful conduct to be established separately through judicial proceedings before a claim for subsidiary liability can subsequently be brought.

As a result, the establishment of unlawful conduct and the imposition of subsidiary liability become separate legal proceedings, which may lead to unnecessary duplication of judicial proceedings, increase the procedural burden involved in protecting creditors' rights, and prolong the resolution of the dispute. This, in turn, may limit, to a certain extent, the compensatory function of subsidiary liability aimed at ensuring the prompt and effective satisfaction of creditors' claims.

Therefore, in our view, it is necessary to improve the mechanism for imposing subsidiary liability under Article 70 of the Law. In particular, the legal requirement that the relevant unlawful conduct must have been previously established exclusively by another judicial act should be reconsidered. Such an

approach may result in the establishment of the unlawful conduct and the imposition of subsidiary liability being resolved in two separate judicial proceedings, which is inconsistent with the function of subsidiary liability as an instrument for the prompt and effective satisfaction of creditors' claims.

A differentiated approach to insolvency in the agricultural sector is necessary because the causes of financial difficulties in agriculture differ significantly from those encountered in many other sectors. First, agricultural production is inherently seasonal. Revenue may be generated within a relatively short period, whereas production expenditures are incurred over a considerably longer period. Second, agricultural assets are particularly vulnerable to biological and climatic risks, and a substantial decline in crop yields or livestock productivity may seriously impair the debtor's ability to perform its obligations to creditors. Third, agricultural enterprises frequently rely on state subsidies and preferential financing. Consequently, unlawful conduct may harm not only the interests of private creditors but also those associated with public financial resources.

Fourth, agricultural enterprises may operate within complex contractual and organizational relationships involving agricultural clusters, cooperatives, processing enterprises, suppliers, banks, and participants in state support programs. These specific characteristics require a more nuanced approach to establishing a causal connection.

Accordingly, the legal framework should distinguish between ordinary entrepreneurial risk and the unlawful creation or aggravation of such risk. This distinction constitutes one of the principal theoretical criteria for determining whether subsidiary liability should be imposed on agricultural business entities.

The analysis led to a number of key scientific conclusions.

First, subsidiary liability in insolvency should not be regarded as merely a traditional form of ancillary civil liability but should be recognized as a specialized institution of insolvency law. Its distinctive nature is determined by the combination of functions related to creditor protection, corporate accountability, preservation of the insolvency estate, and preventive regulation.

Second, a distinction should be drawn between formal and actual control when imposing subsidiary liability. A person's formal corporate status should not automatically give rise to liability where that person did not exercise decisive influence over the debtor's activities.

Third, the insufficiency of the debtor's assets may be regarded as a necessary condition for the practical imposition of subsidiary liability, but it should not constitute an independent ground for liability. The decisive issue is whether the conduct of the controlling person had a substantial causal impact on the occurrence or aggravation of such insufficiency.

Fourth, insolvency in the agricultural sector requires due consideration of objective economic and natural risks. The mere existence of insolvency does not, in itself, establish the fault of a controlling person.

Fifth, the comparative analysis demonstrates the appropriateness of using rebuttable presumptions in cases involving the concealment or material distortion of accounting records, as well as transactions that have caused substantial harm to creditors.

Sixth, the procedural mechanism should prevent unjustified duplication of judicial proceedings. Where necessary, the relevant unlawful conduct should be assessed within the proceedings concerning subsidiary liability itself, while fully safeguarding the procedural rights of the person subject to liability.

Based on the foregoing analysis, several directions for improving the legal framework may be proposed.

First, Article 70 of the Law of the Republic of Uzbekistan "On Insolvency" should more clearly distinguish the following elements of subsidiary liability: the existence of insolvency; the person's status as a controlling person; unlawful acts or omissions; fault; a causal connection between such conduct and the loss of the possibility of satisfying creditors' claims; and the insufficiency of the debtor's assets.

Second, the legislation should establish rebuttable evidentiary presumptions in circumstances that can be objectively verified. Such circumstances may include:

- concealment or destruction of accounting records;
- material distortion of financial information;
- transfer of assets to affiliated persons without adequate consideration;
- entering into transactions causing substantial harm to creditors;
- diversion of agricultural subsidies or preferential loan funds for purposes other than those for which they were provided;
- concealment of agricultural income or production assets.

Such presumptions should be rebuttable and should not, by themselves, automatically give rise to subsidiary liability.

Third, the legislation should expressly identify objective agricultural risks as circumstances that must be assessed by the court when determining causation and fault. Climatic disasters, crop failure, livestock diseases, abrupt market fluctuations, and other objectively verifiable circumstances should be distinguished from conduct committed intentionally or through negligence.

Fourth, Article 70 of the Law should provide that transactions declared invalid by a court, instances of fraudulent or intentional insolvency established by a final and binding judicial decision, and other unlawful conduct should not constitute absolute procedural prerequisites for imposing subsidiary liability, but rather should be treated as evidentiary circumstances subject to judicial assessment. As a procedural mechanism, the court hearing the subsidiary liability claim should be authorized to assess the relevant unlawful conduct within the same proceedings. At the same time, a final and binding judicial decision establishing such conduct should be accorded significant evidentiary weight when determining liability.

This approach would, on the one hand, preserve the ancillary (secondary) legal nature of subsidiary liability and, on the other hand, eliminate the need to establish the underlying unlawful conduct in separate prior judicial proceedings, thereby enhancing the procedural efficiency of applying this institution in judicial practice.

Fifth, the legislation should establish clear criteria for determining the amount of subsidiary liability. As a general rule, the amount of liability should correspond to the portion of creditors' claims that remains unsatisfied as a result of the conduct of the controlling person. At the same time, the court should be empowered to reduce the amount of liability where the controlling person proves

that the actual loss caused by his or her conduct was substantially lower.

Thus, the amount of subsidiary liability should be linked to the total amount of creditors' unsatisfied claims, while allowing for a reduction of liability where the controlling person demonstrates that the actual damage attributable to his or her conduct was considerably less.

Conclusion

Subsidiary liability in insolvency proceedings constitutes a complex legal institution situated at the intersection of civil, corporate, and insolvency law. Although its traditional ancillary nature retains its significance, this characteristic alone cannot fully explain the contemporary structure of liability imposed on persons controlling an insolvent debtor.

The findings of this study demonstrate the need to conceptualize subsidiary liability as a specialized civil-law institution within insolvency law. This institution is intended to maintain a balance between the principle of the separate property liability of a legal entity and the need to prevent persons who have unlawfully impaired the possibility of satisfying creditors' claims from abusing the legal separateness of the entity for their own benefit.

This issue is of particular importance in the context of agricultural insolvency. The relatively low profitability of agricultural business entities, combined with their significant exposure to seasonal, climatic, biological, financial, and market risks, requires a clear distinction between objectively justified insolvency and insolvency caused or materially aggravated by unlawful conduct. Such differentiation is essential for ensuring a fair and proportionate application of subsidiary liability to agricultural business entities.

A comparative analysis of Uzbekistan and selected CIS countries demonstrates that effective legal regulation requires a combination of substantive and procedural mechanisms. Such mechanisms include clearly defining controlling persons, introducing differentiated rebuttable presumptions of evidence, reasonably allocating the burden of proof, recognizing objective agricultural risks, and ensuring that disputes concerning subsidiary liability are resolved within a single set of proceedings where appropriate.

Accordingly, further development of Uzbekistan's insolvency legislation should not be aimed at unjustifiably expanding the scope of subsidiary liability, but rather at establishing a balanced model of liability. Such a model should simultaneously protect creditors, preserve the insolvency estate, prevent abuses by controlling persons, and protect managers and owners who have acted in good faith from unjustified liability for insolvency resulting from legitimate entrepreneurial activity and inherent agricultural risks.

This approach would contribute to the development of a more coherent legal framework for the insolvency of agricultural business entities and strengthen the principles of good faith, responsible corporate governance, and effective creditor protection.

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