

## RUSSIA ALERT

### AMENDMENTS TO THE LAWS REGARDING NEW PROCEDURES OF PLEDGED PROPERTY FORECLOSURE

On January 11, 2009, Federal Law No. 306-FZ, *On Amendments to Certain Statutes of the Russian Federation Regarding the Improvement of Procedures of Foreclosure on Pledged Property*, dated December 30, 2008, came into force.

The law introduces substantial amendments to current provisions governing pledge relationships, in particular—

- Part I of the Civil Code of the Russian Federation (§3 of Chapter 23, and Art. 447)
- Law of the Russian Federation *On Pledge* No. 2872-I dated May 29, 1992
- Federal Law *On Mortgage* No. 102-FZ dated July 16, 1998
- Fundamentals of the Laws of the Russian Federation *On Notary Activities* No. 4462-I dated February 11, 1993
- Federal Law *On State Registration of Rights to Real Estate and Transactions Therewith* No. 122-FZ dated July 21, 1997
- Federal Law *On Insolvency (Bankruptcy)* No. 127-FZ dated October 26, 2007
- Federal Law *On Enforcement Proceedings* No. 229-FZ dated October 2, 2007
- Federal Law *On Joint Stock Companies* No. 208-FZ dated December 26, 1995
- Federal Law *On Amendments to Certain Statutes of the Russian Federation Related to Adoption of Federal Law On Pawnshops* No. 197-FZ dated July 19, 2007.

The law will apply to legal relationships arising after January 11, 2009. It amends and revises the procedures for foreclosure on pledged movable and immovable property and the sale of such property. In addition, the law sets forth certain rules for settlement of the creditor claims secured by a pledge of the debtor's property in bankruptcy proceedings.

The most substantial amendments introduced by the law include the following—

#### NEW METHODS OF SALE OF PLEDGED MOVABLE PROPERTY

The law allows the following new methods of sale of pledged *movable* property—

- The pledgee takes possession of the pledged property.

- The pledgee sells the pledged property to a third party (without a public auction), either directly or through a commission agent, under an agency agreement between the pledgee and such commission agent.

These methods may be used *only*—

- between legal entities and individual entrepreneurs
- if the parties (whether in the pledge agreement or in a special agreement) have agreed to allow an extrajudicial foreclosure on pledged property
- if a particular method is expressly provided for in the pledge agreement or in a separate agreement on extrajudicial foreclosure on pledged property.

#### **AMENDMENT OF THE PROVISIONS GOVERNING THE EXTRAJUDICIAL FORECLOSURE PROCEDURE**

- Extrajudicial foreclosure may be applied if the parties have expressly so agreed (previously, foreclosure on *movable* property could be effected extrajudicially, *unless* the parties had agreed otherwise).
- An agreement on extrajudicial foreclosure on pledged property (as well as on mortgaged real property) may be entered into at any time and may be incorporated into the relevant pledge or mortgage agreement.
- Notarization of the pledgor's consent to extrajudicial foreclosure on pledged *movable* property is required only if the pledgor is an individual. The consent notarization requirement always applies to *immovable* property.

#### **AMENDMENT AND MODIFICATION OF THE PROVISIONS GOVERNING FORECLOSURE TRIGGERING EVENTS**

- It is specified that, in case of the pledgor's default, the pledgee becomes entitled to foreclose on the pledged property starting on the maturity date of the obligation secured by the pledge. A different rule may apply where, pursuant to law or contract, such right arises at a later date, or if the law permits foreclosure at an earlier date.
- The materiality criteria—pursuant to which a breach of an obligation secured by a pledge may qualify as immaterial, and the amount of the pledgee's claims determined to be inadequate to the pledged property value—have been clarified. The foreclosure on the pledged property is presumed to be prohibited if the following conditions are met: (i) the amount of the breached obligation is less than 5 percent of the appraised value of the property pledged under the pledge agreement, and (ii) the period during which the obligation secured by the pledge remains overdue is less than three months.

Such presumption may be rebutted if the pledgee proves materiality of the breach.

- Special terms have been provided for a breach of an obligation paid in installments. Foreclosure on the property securing such obligation is allowed if the pledgor is in arrears of its payments three times within 12 consecutive months (even if such defaults individually qualify as immaterial).

## **AMENDMENT OF THE PROCEDURE AND CONSEQUENCES OF SUBSEQUENT PLEDGE FORECLOSURE**

If a foreclosure is initiated under a subsequent pledge, the prior pledgee may *accelerate* the obligations secured by the prior pledge and bring about foreclosure on the pledged property, even if the original obligations have not yet become due.

If the prior creditor fails to exercise the right of early foreclosure on the pledged property, such pledged property sold as part of a subsequent pledge foreclosure will be transferred to the acquirer encumbered by the prior pledge.

## **MANDATORY ENGAGEMENT OF AN APPRAISER**

The law requires engagement of an appraiser in the following cases of an extrajudicial foreclosure on the pledged property—

- if the pledged *movable* property consists of—
  - securities not traded on an organized stock exchange (with some exceptions)
  - property rights (other than receivables that may not be sold at an auction)
  - precious metals or stones, precious metals or stones items or scrap
  - collector value banknotes
  - articles of historic value and works of art
  - things or objects whose value as stated in the pledge agreement exceeds RUR 500,000
- if the pledged *movable* property is sold under a commission agreement
- if it is necessary to determine the initial sale price for the purposes of an extrajudicial sale of—
  - immovable property leasehold rights
  - claim rights of an investor arising from a joint construction project or
  - immovable property whose value as stated in the mortgage agreement exceeds RUR 500,000.

## **MORTGAGED IMMOVABLE PROPERTY FORECLOSURE PROCEDURE:**

The list of the types of immovable property on which foreclosure may be effected only by court procedure has been extended to include the following—

- residential premises owned by individuals
- federal or municipal property.

The initial sale price of mortgaged immovable property sold at an extrajudicial public auction that is required to be appraised must be set at 80 percent of the value of the immovable property as determined in the appraiser's report, unless the parties agree otherwise.

The law sets forth detailed requirements to the mortgaged property sale procedure in case of an extrajudicial foreclosure.

#### **CHANGES IN THE ORDER OF PRIORITY OF THE CREDITOR CLAIMS SECURED BY A PLEDGE OF THE DEBTOR'S PROPERTY IN THE EVENT OF BANKRUPTCY**

Creditors' claims secured by a pledge/mortgage of the debtor's property are recorded as third priority claims. It should be noted, however, that 70 percent of the proceeds from a sale of the pledged property (80 percent if the pledge secures obligations under a credit agreement) will be first applied to satisfy the claim secured by such pledge/mortgage on a priority basis vis-à-vis any other claims, including—

- any first or second priority claims (regardless of when the same arise) and
- payment of litigation costs, receivership fees and the fees of any persons engaged by the receiver.

The remaining 30 percent (or 20 percent, if applicable) of the proceeds will be applied to satisfy the above said claims.

#### **FORECLOSURE PURSUANT TO A NOTARY'S EXECUTIVE ENDORSEMENT**

In the event that a pledgor fails to honor the agreement on extrajudicial foreclosure on the pledged property, the foreclosure may be effected on the basis of a notary's executive endorsement on the relevant pledge or mortgage agreement. The executive endorsement should, among other things, specify the initial sale price of the property.

#### **SUSPENSION OF THE APPLICATION OF THE MANDATORY SHARE BUY-OUT OFFER REQUIREMENT (ART. 84.2 OF THE FEDERAL LAW *ON JOINT STOCK COMPANIES*)**

The requirement for an acquirer of more than 30 percent of the voting shares of an open joint stock company (OJSC) to make a public offer to all shareholders of such company regarding buyout of their shares (or other securities convertible into shares of the OJSC) will not apply before January 1, 2010, in the case of an acquisition of OJSC shares pledged to secure obligations to a "credit organization" (i.e., a bank or other licensed lending institution) when such shares are acquired by—

- the credit organization as a result of the foreclosure upon such shares or a settlement
- third persons from the credit organization that has acquired such shares as a result of the foreclosure upon such shares or a settlement
- third persons at an auction or through sale to third persons in the course of the foreclosure upon such shares or as a result of a settlement.

#### **CONTACT INFORMATION**

If you have questions about this alert, please contact:

Alexey Kondratchik ..... 7.495.783.7700 ..... akondratchik@akingump.com ..... Moscow  
Andrei V. Danilov ..... 7.495.783.7700 ..... avdanilov@akingump.com ..... Moscow