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A practical cross-border insight into lending and secured finance

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Country Question and Answer Chapters:

Russia

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The crude oil price crash and EU and US sanctions against Russia related to the situation in Ukraine, both followed by the dramatic depreciation of the Russian rouble (approx. 50% in 2014 and 17% in 2015), have influenced the Russian economy and financial market for the last couple of years. Russian banks were cut off from financial resources outside the country. Many loans nominated in foreign currency became too burdensome for borrowers, which resulted, in some cases, in the restructuring of debts, judicial disputes and bankruptcies. Many projects have been suspended or cancelled. Most banks changed their lending policies; some of them even limited their corporate lending programmes, and therefore corporate lending has never been so sought after by Russian businesses.

From a legal standpoint, recent years have seen major reforms aimed at the improvement of legislation. Some of them are still in progress. The Russian Civil Code was amended in 2014, the new rules on pledge having taken effect in July 2014. Pledge of receivables, pledge of bank account, a pledge register for movable property and many other mechanisms are now described in the text of the Civil Code in detail.

Previously, there was a major issue with pledges: pledged assets had to be described in detail for a pledge to be valid and enforceable. There have been many cases when a pledge was challenged due to the fact that the assets were not determined. The law is now more reasonable and allows for flexibility: all or part of the assets can be collateral and even the future assets of the company can be included into the contract, with reasonable description.

Pledge managers have been introduced into the Civil Code, which is important for syndicated lending.

A *register of notices of pledge of movables* has been created, enabling pledgees to ensure their rights with respect to third parties.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In September 2015, Uralkalyi, a major Russian company and the world's largest producer of potassium fertilisers, received credit from Sberbank of USD 1.5 billion (previously, in April 2015 it also received syndicated credit from Commerzbank, IKB, Industrial Commercial Bank of China and China Construction Bank of USD 650 million).

In 2014, the mostly state-owned Sberbank organised a bridge loan for a Gazpromneft & Novatek joint venture of approximately USD 3 billion to increase participation in Italian oil company Eni, the final goal being rights to the subsoil use in Yamal-Nenetsk Autonomous Region.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

There are two different types of guarantee in Russia.

The first is a surety, when the guarantor becomes liable together with the party to the contract (borrower); in cases where the borrower fails to perform, the creditor may claim compensation from the guarantor, which must be in writing. The surety depends on the validity of the main obligation (or contract) and usually secures rights of the creditor under a particular transaction, although, since 1st June 2015, if a surety is given by commercial organisation, it can cover all existing and even future debts of the debtor.

The second is a so-called "independent guarantee", which replaced bank guarantees after 1st June 2015 (which could only be issued by a bank). Under an independent guarantee the guarantor (a commercial organisation) shall pay the agreed amount in case the creditor claims for the money. An independent guarantee remains in force even if the main obligation (contract) is void or avoided. It must be in written form.

As a general rule, any company can provide any of the above-mentioned guarantees, including a member of the group.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There is no special regulation on enforceability or director liability if only a small benefit to the guarantor can be shown.

However, according to the general rules and principles of law, a director of a company is to act in good faith to the benefit of the company; otherwise, the director can be liable for the damages incurred.

If there was no approval by the shareholders of the guarantor (if required) or if the guarantor became bankrupt and the guarantee violates the rights of creditors, surety or independent guarantee can in some cases be challenged in court. In such situations, absence of benefit may help convince the court that the guarantee is voidable.

2.3 Is lack of corporate power an issue?

The aspect of lack of corporate power due to the limitations of legal capacity is important only from a strictly formal point of view. The company can limit its legal capacity and its business purposes in the charter. The deal can be challenged in the court if the other party knew or should have known about such limitations.

However, in practice the companies usually do not limit their legal capacity in their charters/by-laws/articles of association. This can be different in companies which are owned by the state: such companies may have special purposes and may have limited powers.

It is much more common for there to be a lack of corporate approvals (please see question 2.4 for details).

One should bear in mind that in September 2014 the *Four-Eyes Principle* became available to companies: now there can be more than one director (CEO) in the company. The charter may provide that the directors act jointly (two or more signatures are required) or separately (only one signature is required). The directors may have different powers that should be set forth in the charter of the company. To check the number of directors and their names, one can address the Unified State Register for Legal Entities, which is also available online at www.egrul.nalog.ru (in Russian). To check their powers, the charter should be analysed.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Yes, corporate approvals may be (and, in large-scale transactions, usually are) necessary. There are generally three types of transaction approvals that may be required:

- for a *large-scale* (major) transaction (a transaction which amounts to **25% or more of the net assets** of the guarantor) the approval of the board of directors or a shareholders' meeting may be necessary;
- for a transaction which may amount to less than 25% of the net assets of the company, but the approval of which is required according to the **charter** of the company, the approval of the board of directors or a shareholders' meeting may be necessary; and
- for *"interested-party" transactions* (a transaction which may result in the benefit of the **affiliates** of the guarantor) the approval of the board of directors or the shareholders which are disinterested in the transaction may be necessary.

To make sure the deal will not be challenged in court, one should check the charter of the company, check the balance sheets and, if necessary, receive the necessary corporate approvals.

There is no special governmental control over guarantees and no consents or filings are required.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There is no *ex ante* control or limitations imposed on the amount of the guarantee. However, *ex post*, the guarantee can be challenged in the bankruptcy proceedings if it violates the rights of creditors.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There is no special regulation on the enforcement of a guarantee with regard to exchange control or similar. However, there are certain bank formalities that a company shall comply with according to the currency control.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

According to the new text of the Russian Civil Code effective from 1 July 2014, any assets, objects and rights can be used as collateral (pledge) with some minor exceptions (e.g. assets which cannot be foreclosed and rights which are inseparably connected with the personality of the creditor, such as alimony and others, cannot be used as collateral).

In fact, movables and immovables, rights to receivables, bank accounts (including deposits), stock, bonds, rights of participants of the companies (shareholders' rights) and exclusive rights to intellectual property can be used as collateral. Pledge of immovable property is also called a "mortgage" and is traditionally regarded as one of the most reliable types of security.

If the pledger is a commercial organisation, the pledge agreement may provide that the pledgee may retain the collateral in his ownership (it is not a general rule).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

From 1st January 2015, the amendments regarding the pledge of all assets (total, or comprehensive, pledge) entered into force, making it possible for entrepreneurs to provide all or part of their assets or certain types of assets (e.g. all vehicles or all equipment) as collateral. However, these provisions are still to be tested in practice and the rules on crystallisation of the assets shall be created through practice.

The above must be in written form. The parties may agree that notarial certification is necessary. If the pledge agreement secures the contract which was notarised, it also needs to be notarised. Defects in such will result in nullity of the pledge.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. The agreement shall be in written form and in some cases may require notarisation. A pledge of real property (land, buildings) shall be registered in the Register for Rights to Real Estate (*Государственный реестр прав на недвижимое имущество и сделок с ним*), otherwise it shall have no legal effect with respect to third parties.

Pledge of machinery and equipment shall usually be deemed as a pledge of movables. The agreement shall be in written form and may require notarisation in some cases. The pledge of movables can be registered in the electronic register for movable property which ensures that third parties are informed about the pledge even if they acquire rights to them. This register was introduced in mid-2014 and is maintained by notaries public.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, pledge of receivables is possible and, after the amendments of mid-2014, more flexible. Generally, this must only be in written form. There are certain limitations when pledge of receivables is impossible (e.g. assignment is impossible under the law).

The debtor shall be notified of the security.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, the text of the Russian Civil Code, updated in 2014, provides for such an instrument.

An agreement between the pledgor and the pledgee is required in written form (and sometimes requires notarisation). A special collateral account in the bank shall be opened. There are generally no restrictions on who can be the pledgee, e.g. the bank where the pledged account is opened. The pledgor may dispose of the money on such account, unless otherwise provided by the agreement. In case the pledgee informs the bank on default of the pledgor, the bank shall not make any transactions with the account which result in a decrease of the sum on it below the pledged amount.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

There are two types of pledge over shares in companies: pledge over shares in joint-stock companies (JSC or, in Russian, *AO*); and pledge of shares (participation interests) in limited liability companies (LLC or, in Russian, *OOO*). The shares are not in certificated form.

Pledge over shares (the agreement must be in written form, though notarisation is usually not required) in a JSC shall be registered by the special company which maintains the register of the JSC. As a general rule, the shareholder reserves the right to vote.

Pledge over shares in an LLC shall be notarised. A simple majority (or even more, if provided by the charter) of votes of other shareholders is necessary for the pledge to be valid. Pledge is registered in the Unified State Register for Legal Entities and the LLC is notified about the pledge by a notary public.

For practical reasons it is not recommended to use foreign law as the governing law of the agreement, but there are such cases (although not common) in practice. Due to the fact that pledge over shares in an LLC is to be notarised and notaries public cannot check the consistency of the pledge agreement under foreign law, such transaction is unlikely to be validated through notarisation.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, it can. A written form of the agreement is necessary (notarisation is usually not required). The value of the pledged inventory shall not be less than that agreed. As a general rule, the pledgor shall maintain the register of such pledged inventory, recording all incoming and outgoing transactions.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Generally, a company can guarantee both its own debt and the debt of other borrowers and/or guarantors, subject to the limitations described in questions 2.3 and 2.4 above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

There is no stamp duty in Russia.

The registration fees are moderate and can usually be neglected.

The most significant is the notarisation fee which is calculated from the price of the transaction (up to 0.5%). Notarisation is necessary when: i) the secured obligation has been notarised; ii) the pledge over shares in a limited liability company is in question; and/or iii) the parties agreed to use notarisation (e.g. for a non-judicial procedure of foreclosure, if applicable).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Usually the procedure requires a moderate amount of time and expense. Pledge of movable assets can be done relatively fast and easily. Pledge of immovable assets (and intellectual property), which requires registration in state bodies, may take, approximately, an additional month. Expenses are usually connected with notary fees.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Usually there are no such consents required (see also questions 2.3, 2.4 and 3.6 above), if the rights of third parties are not considered.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There is an issue of describing the secured obligation in Russia, if such description is not concrete enough. However, in 2014 the law was amended, clearly stating that pledge of future debt is also possible, and the wording of the law is now more flexible for entrepreneurs willing to secure future debt (e.g. in cases involving a revolving credit facility). No special priority is provided.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

The agreement must be in written form (in practice this is usually done as a single document, not by means of exchange of the signed copies). Notarisation may be necessary (please see question 3.9 above). An additional copy is necessary if registration is required (for the archives of the registration authority).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Currently, there is no special regulation of "financial assistance" in Russia as there is, for example, in Germany. However, the company's CEO may require approval for the deal. See question 2.4 above for types of approval.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Pledge managers were introduced into legislation in June 2014, enabling creditors to choose one of the creditors or a third party as a person who will sign a pledge agreement with the pledgor and/or exercise all rights and duties of the pledgee under such agreement. The legal provisions governing agency relationships (in Russian – *поручение*) are applicable to the duties of the pledge manager, and the relationships between the creditors are governed by the provisions of simple partnerships – unless otherwise provided by the agreement of the parties – or stems from the essence of the obligation. This is yet to be tested in practice.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please see question 5.1 above. Major syndicated lending transactions in Russia have usually been governed by foreign law, although there were examples when the same documentation was used under Russian legislation with the arbitration clause providing Russian state arbitrazh courts as a place for dispute resolution. The situation may change in the future when practice finds it reasonable to use pledge managers for these purposes. Hopefully, based on the principle of freedom of contract, set forth in the Civil Code and elaborated in the recent clarifications of the former Supreme Commercial Court, the contract for pledge management will include provisions on monitoring the status of the debt, solvency of the debtor, enforcing loan documentation, etc.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Such transfer is usually done by means of assignment. Generally, the consent of the debtor (guarantor) is not required, unless otherwise provided by the agreement.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Generally, interest payable on loans is regarded as income and is subject to Russian corporate income tax (CIT). Russian borrowers shall be a tax agent for the lender and shall withhold CIT from the interest payable (there are exceptions, *inter alia*, when there is treaty between the countries on avoidance of double taxation). Taxation of the proceeds of a claim under a guarantee or the proceeds of enforcing a security generally follows the rules of the main obligation (i.e. only interest is taxable).

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no special incentives for foreign lenders. No special taxes are provided for purposes of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

Generally, if a company has no representative office in Russia from the standpoint of the tax legislation, it shall not become taxable in Russia solely because of the loan/guarantee/security. However, the interest on the loan may be subject to corporate income tax (see also question 6.1 above).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Generally, notarisation is not necessary. However, the parties may decide otherwise; in this case notary fees may be considerable as they are calculated based on the sum of the transaction. For expenses during pledge agreement execution, please see question 3.9 above.

6.5 Are there any adverse consequences to a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Generally, there are no such consequences under Russian law.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, generally the courts recognise a foreign governing law and enforce the contract if this does not violate mandatory Russian laws, principles and public order. The court may ask for clarification of the foreign governing law from the party and may ask an expert to prove that the interpretation of the foreign law by the party is correct.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In principle, judgments of foreign courts can be recognised in Russia. However, there are some requirements for this: presence of an international treaty; or reciprocity principle. There are no such agreements between Russia and the USA or UK. The principle of reciprocity is quite unreliable and means providing evidence of recognition and enforcement of Russian courts' decisions in foreign jurisdictions and may depend on the political situation. However, should the requirements be met, the court will not re-examine the merits of the case unless public order in Russia is violated.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Statutory term (which can be prolonged, e.g. if the case is difficult or the notice of a foreign party is required) for the court of 1st instance to issue a decision is three months after the claim is filed. It takes an additional month for the decision to enter into force. The minimum time for execution of the decision (if executed through the bank, as opposed to the state bailiffs' service) is approximately one week. In practice it takes about six months, if there is no appeal, for both filing a suit in a Russian court and enforcing a foreign judgment. Often, if a foreign company wishes to participate in a Russian court not through a Russian lawyer, there is a significant problem regarding notice: notices are made officially (not by post, but through state authorities of the respective countries) and usually take several months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

In practice, judicial enforcement is often necessary if the debtor objects to enforcement of security (see question 7.3 above). In most cases the pledged assets are to be sold via an auction (usually takes a couple of months). In 2014, certain amendments have been made to the Civil Code, reducing complexities for the pledgees. According to such amendments, entrepreneurs may agree that the pledged assets will be transferred to the pledgee or sold to a third person, the price being not less than the market price. This may significantly reduce the terms for enforcement of the collateral security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction or (b) foreclosure on collateral security?

Generally, there are no such restrictions.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, there is a moratorium on enforcement of lender claims in bankruptcy. Usually the pledged assets can be sold within the final stage of bankruptcy and the pledgee may receive from 70 to 80% of the sale price.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Russia is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958); therefore, generally, no re-examination of merits is required and the award can be enforced.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy of the borrower usually means that the collateral security can be enforced when the final stage of bankruptcy commences (receivership). Depending on the type of secured obligation and the type of pledge, the creditor may receive from 70 to 80% of the value of the pledged assets, but in any case not more than the debt.

If the pledge of bank account is considered, there is no need to sell the assets, and therefore no expenses for the auction will be deducted from the final sum.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

As indicated in question 8.1 above, secured creditors can receive only up to 70 or 80% of the value of the pledged assets. The rest of the sum

is divided between the bankruptcy manager (bankruptcy proceedings expenses, bankruptcy manager fee) and the preferential creditors, such as employees, injured persons (tort claimants), authors, etc.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Legal entities with state participation may be excluded from bankruptcy; special rules apply.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

There is no alternative to judicial enforcement in bankruptcy.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A Russian court will recognise a choice of foreign law and submission to a foreign jurisdiction provided that it is not illegal or contrary to Russian public policy.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A Federal law on Foreign States Immunities has recently been adopted (Federal law No. 297-FZ dated 3rd November 2015). According to the law, a foreign state may waive its immunity (either in an international treaty or in a contract). Certain procedural actions are also regarded as waiver (e.g. participating in a court dispute on the merits).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Generally, any company may be a lender in Russia. Domestic banks, that is, the organisations whose main purpose is financial services, must have a licence granted by the Central Bank of Russia. Foreign banks must have an equivalent status according to their *lex personalis* (their domestic laws).

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Currently, one of the most important considerations is the legislation which has undergone significant reform. The changes have yet to be put into practice. Moreover, after the 2014 judicial reform in which the Supreme Commercial Court was dismissed and substituted by the Supreme Court with a subdivision for commercial disputes, there is still no understanding as to whether the courts will maintain the recent flexible and active approach or stick to the formal wording of the law and interpret it conservatively.

Currency exchange rates should be taken into account and special provisions may be necessary to guarantee stability under contracts formed in Russia.

Finally, it is necessary to remember the formalities described in the sections above (written form, registration and notarisation, if required, corporate approval in written form), which may seem excessive in a particular situation, but the neglect of which may result in long-term court disputes with high expense.

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- Real Estate & Construction;
- Antitrust Law; and
- Labour Law.

The Company has great experience in structuring M&A transactions. Another core practice of the Company is litigation (including bankruptcy cases and disputes with state authorities) and international commercial arbitration.

Mosgo & Partners is a member of the German-Russian Chamber of Commerce (*Deutsch-Russische Auslandshandelskammer*). The Company's partners are members of the International Bar Association.

Other titles in the ICLG series include:

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- Aviation Law
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- Cartels & Leniency
- Class & Group Actions
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- Copyright
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- Corporate Tax
- Data Protection
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- Enforcement of Foreign Judgments
- Environment
- Franchise
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- International Arbitration
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
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- Trade Marks

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