



Commercial Real Estate

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Russia

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Leasing

Practical points

(a) *Securing the premises*

As a general remark, it is necessary to note that the Russian legal system is a continental one by its nature. The rules which influence the relationships between the investors, occupiers, owners, developers, etc. are provided by the laws. Among the most significant are: the Civil Code (**CC RF**), which provides general regulation on contracts, security, status of the immovable, its registration etc.; the Land Code, which handles such issues as categories of land, types of permitted use, procedures of disposal of land by the state, etc.; and the City-Planning Code, which provides rules on construction of premises in the settlements. The parties are free to agree on terms which are not provided by the law unless its provisions are mandatory by its nature.

In most cases, rights to immovables are registered in the Unified State Register of rights to immovable property and transactions therewith (**the Register**) and can be set against third parties only after such registration (some exceptions are described below). The registration influences the opportunities and risks of the parties. One should bear in mind that absence of registration may result in invalidity of the agreement in certain cases. Without registration, the party to the contract may rely mostly on monetary remedies, whereas claiming the immovable object in kind may be impossible.

Returning to the issue of securing the premises, for those which are under construction or currently being occupied by a third party, the considerations mentioned above will be important as well.

To secure occupation of the premises in advance of them being constructed, the occupier can posit the construction of a 'future thing' lease. For several years, it has been a question whether such contract is valid under Russian law. The law provided that the lessor under a lease contract must have had the right of ownership to the premises. The judicial practice was unsustainable; in some cases, the courts said that such contract is void as contradicting the law. Nevertheless, in 2013, the clarifications of the Supreme Commercial Court of the Russian Federation (**the SCC**) were issued, stating that the lessor shall have the right of ownership by the moment of the transfer of the premises to the occupier, not at the moment of conclusion of such contract. Therefore, such contracts are not void and can be used as an instrument of securing the occupation of the premises in advance of them being constructed.

The occupier can also secure his right to premises that are currently occupied by a third party. It is generally possible to conclude a lease agreement which enters into

force after the third party vacates them. However, the tenant has a preferential right to prolong the lease agreement. If this right is violated by the lessor, the tenant may use the right to ask for transfer of the contract in his name. It means that the new occupier should check that the lessor has offered the previous occupier to prolong the contract on the same terms as the new occupier wishes it to be concluded.

However, both these options leave some space for risk, because these contracts will not be registered in the Register (*see above*). It means that the owner will have the opportunity to conclude several contracts for lease of the premises with several persons, not knowing about each other's existence.

Russian law provides that contracts of lease of immovable things shall be registered, if their term is more than one year. The contract, which has not been registered in the Register, cannot be set against rights of third parties.

(b) *Taxes and fees payable*

Generally, leasing between companies is an operation which is subject to VAT (18%). The sum is usually indicated clearly in the contract. If the contract contains no provision on whether VAT is included in the rent amount or not, there can be disputes in the courts; therefore it is recommended that this issue be expressly covered by the contract.

In some cases, VAT may be not applicable due to particular circumstances; it requires verification before signing the agreement.

There is a fee for registration of right of lease in the Register: RUB 2,000 (€30) for natural persons; and RUB 22,000 for legal entities (approx. €300).

Notarisation is not necessary for the lease contract, but can be used at the discretion of the parties (it also facilitates the further registration in the Register, if necessary, and reduces the term of such registration). In the latter case, a notarial fee may be applicable.

(c) *Fitting-out works*

Fitting-out works and alterations are not clearly distinguished in Russian law. It only distinguishes between the alterations which can be removed and which cannot be removed from the premises. In the latter case, if the alterations are made without the consent of the owner, their price cannot be claimed from the latter.

The law does not provide that an occupier needs to obtain the owner's approval for the works that it wishes to carry out. However, in most cases the lease contracts do contain respective provisions. It is often impossible to carry out works within the object without the approval of the owner from a practical point of view. It is also important to note that many types of changes of the premises shall be approved by the local authorities and, in some cases, registered in the state cadastre (for example, if a wall is being removed). Certain improvements may influence industrial safety and require checks with the fire service or other state authorities.

There is no special procedure set out in the law, nor a standard set of documents required for obtaining such permission of the owner. Such procedure and fee for permission may be contained in the contract, but not in practice. As can be seen from the above, it may require approvals of state authorities. A plan of work and an application or a letter to the owner may also be required.

It is not usual to obtain approval of the owner before the occupier takes possession of the premises, but there are no formal restrictions for that either. It means that if the occupier and the owner agree on certain works, they can even include this in the lease agreement or a supplementary agreement thereto.

(d) *Codes of practice*

In general, there are no codes of practice in the sphere of lease of premises that could help in negotiating the occupational documentation and/or govern the relationship between an occupier and owner. However, the Civil Code of the Russian Federation contains the main provisions on lease, and lease of immovable things in particular, some of which are default and can be changed by the parties' agreement, while others are mandatory and cannot be altered. The text of the code can be found on the internet in English.

Key commercial terms

(a) *Rent*

Rent amount is the condition *sine qua non* for the lease of premises agreement. In its absence the contract is regarded as not concluded, which is similar to a void contract. Rent amounts for the private sector are determined by the parties. If a public owner lends the premises, the amount of the rent is usually determined based on the local legislation.

Rent is usually paid monthly, but the law does not provide any restrictions on the term of payments. The parties can agree on annual, quarterly or weekly payments or another system of payment (e.g. one-time payment) or even another type of consideration (services, things, improvements of the premises, etc.) and their combinations of any kind.

Rent is usually calculated on the basis of rent per square metre.

(b) *Rent adjustments*

The parties may agree that the rent increases, decreases (or even both at different periods of time) during the period of occupation. The law provides no restrictions on rent adjustments (except the general principles of civil law, such as fairness of contract conditions, for example). Rent can be indicated in foreign currency (although payment between Russian organisations can be made in Russian roubles only) to prevent the change of currency rate risks. Rent can also be calculated on the basis of a formula – the law is very flexible in this regard.

(c) *Other occupational costs*

The lease contract quite often contains provisions according to which the rent is divided into several parts, among which are the costs for utilities (electricity, water, gas, etc.) – which are paid based on actual amount of the resources used. However, in many cases all the costs are included in the rent amount. To avoid disputes, the contract should contain express provisions regarding all possible occupational costs.

Insurance may be the duty of the tenant under the contract.

Service charges (for services that benefit all tenants) are not very common.

(d) *Period of occupation*

In most cases, the law provides no restrictions as to the period of occupation (there are certain exceptions, mostly in the lease of public land sphere). Contract of lease of premises for one year or more shall be registered in the state Register, so many companies conclude contracts for a period of less than 365 days to avoid this procedure (which, however, gives fewer guarantees for the occupier).

The lease contract may also contain no provision about the term of the occupation at all. In this case, such contract can be terminated by either party with prior notice (default rule – within three months before termination of the contract).

Lease contracts with very long periods of lease (e.g. 50 years or more) can appear suspicious to the state bodies and in some cases can be treated as contracts of sale and purchase. Therefore, very long periods of lease are not very common.

(e) *Remaining in occupation*

The occupier has a preferential right for a further lease. The owner can request to change the conditions of the lease (e.g. to increase rent). However, if after that the owner decides to reduce the amount of rent, the previous occupier has the right to ask for transfer of the lease agreement to him so that the previous occupier becomes the party to that agreement or he can claim for damages.

If the occupier continues using the premises after the expiration of the term of the lease without any objections from the owner, the lease agreement transforms into at-will tenancy, without a fixed term (*see paragraph “d” above*). Otherwise may be provided in the contract.

On 1 June 2015, the notion of an “option” has been introduced into the CC RF (art. 429.2) (previously recognised by practice, but sometimes risky in case of court disputes) and therefore the occupier may request to include the right for a further lease into a lease contract as an option.

(f) *Disposing of the premises*

If the occupier no longer requires the premises, there can be three ways to dispose of the premises:

(i) Termination of the lease contract. If the lease had a fixed term, usually it cannot be terminated without responsibility of the occupier for breach of contract (usually damages may amount to the rent amount due for future periods, or a contractual penalty). Otherwise may be provided by the contract.

If the lease had no fixed term, prior notice is required (*see paragraph “d” above*).

(ii) Assignment of the contract of lease – usually with the consent of the owner;

(iii) Subletting – usually with the consent of the owner.

(g) *Alterations*

Please see ‘Practical points’, paragraph “c” above.

(h) *Repair of the premises*

Capital (fundamental) repairs are usually done by the owner, current and ordinary repairs being the occupier’s duty – unless otherwise provided by the agreement. The distinction between capital and non-capital (current) repairs is not very clear, although in case of disputes the courts usually refer to the definitions of these from the field of construction law.

All alterations are usually to be removed after lease termination or expiration. Sometimes contracts provide that after the lease the occupier is to do minor repairs of the premises (renovate the walls, the floors, etc.), for which a deposit is usually used as a security. *Please also see ‘Practical points’, paragraph “c” above.*

Investment

Practical points

(a) *Exclusivity*

Rights to immovable things shall be registered in the Unified State Register of rights to immovable property and transactions therewith (the Register). The right of ownership

is transferred to the new owner by the registration. After such registration, the right can take effect with respect to third parties.

In case the investor has a contract with the owner, but the right is not registered, the investor will bear the risk that the same property can be sold to third parties which are not aware of the transaction. In case of such breach of contract by the owner (seller), the investor will only have the right to claim for damages or other monetary compensation, not for property, if it has been transferred to a third party.

Unfortunately, Russian law does not provide for a provisional record in the Register (e.g. as in Germany, Vormerkung, §883 BGB) that could serve as a guarantee that the premises are not sold to a third party.

To increase the chance that the property will nevertheless remain with the investor, a pledge (mortgage) can be used. Such mortgage shall also be registered in the Register. So, if the owner changes his mind and tries to sell the property, the record in the Register will be the evidence of mortgage for the third party, and will probably be inappropriate for such third party as a buyer. It will also secure the investor's claim for damages (or penalty) incurred through violation of his rights by the owner.

The investor may also use an option to conclude a contract for purchase of premises.

(b) *Restrictions on disposing of property*

It is noteworthy that in Russia the building and the land plot are different objects. In spite of the principle according to which the land and the building can be sold only together, it quite often occurs (mostly due to historical reasons) that the building is owned by one person whereas the land is owned by another. Nevertheless in most cases, transfer of rights to the building triggers transfer of right to the land thereunder.

There are generally no restrictions on disposing of the property. However, if the land is considered, one should bear in mind that agricultural land as well as some other special categories of land (located near the frontier, military zones, etc.) cannot be owned by foreigners and in some cases even by their Russian subsidiaries.

(c) *Impacts on timing*

Apart from negotiations and preparation of the contract, the most time-consuming aspect is the process of registration of right in the Register. However, in 2015, amendments entered into force, reducing the term of the registration procedure to 10 working days. If the parties use the notarial form of the contract, the term is even less – three working days.

Time may be required to obtain necessary approvals from the corporate bodies (e.g. if the transaction falls under the categories of major (more than 25% of the assets of a company), interested-party transactions, or requires approval due to special provision of the charter (by-laws) of the company).

(d) *Key milestones in the acquisition process*

The acquisition process does not require too many formalities. In practice, it includes negotiations, drafting a contract, preparation of necessary corporate documents (approvals, decisions, etc.), visiting the notary (if the parties decided to do so) and registration of title in the Register. If possible, the parties usually try to avoid any gaps between signing the contract and actual transfer of property, to reduce the risks.

(e) *Requirement for transfer of monies*

There is no legal requirement as to the time of transfer of money for the premises. It

may be divided into several stages to make the payment process more balanced from the standpoint of both parties. For instance, one instalment can be made after signing the agreement (or even before it, as an advance), the next one after submission of the documents for state registration in the Register, the next one after the registration, and the final one after some period of time, when it becomes evident for the new owner that the property is indeed in good order (e.g. six months).

The last payment can also be connected with statutory limitation periods to cover legal risks. For example, one year is the minimum term for contesting voidable transactions; three years is the general statutory limitation period (e.g. for the claims of creditors); and 10 years is a limitation period for certain types of void transactions to be contested in the court. These limitation periods can be taken into account when dividing the final part of the price of the premises.

(f) *Execution procedure*

The contract of sale of immovable things shall be executed in writing in the form of a document, signed by both parties, otherwise it is invalid. Exchanging fax copies or emails in this particular case can be regarded as invalid form. Moreover, the registration authority will also require the original document. It is usually prepared in several counterparts: one for each party and one for the registration authority's archive.

(g) *Other procedural requirements*

Notarisation is at the discretion of the parties (it reduces the terms of further registration and legal risks, but will be more burdensome and expensive).

Registration in the Register is required for the transaction to be effective with respect to third parties.

(h) *Taxes and fees payable*

VAT (18%) is generally applicable for a transaction between two organisations. However, purchase of land is not subject to VAT. Therefore, when preparing an agreement on sale and purchase of building and land thereunder, the price is to be indicated separately, so that VAT may be calculated. Evidently, this tax issue may influence the amount of the price indicated as price of land, and the one shown for the building.

The buyer should also bear in mind that premises owned by a company may also be subject to corporate property tax (up to 2.2% of the value of the asset, depending on the regional legislation). Usually premises are bought with land – land tax may be applicable (this varies in different regions and municipalities, but cannot be more than 1.5% of the cadastral value of the parcel of land).

A fee for registration in the Register is RUB 2,000 (€30) for natural persons and RUB 22,000 for legal entities (approx. €300).

A notarial fee may be applicable if the parties decide to use a notarised form of the contract of sale of premises.

Key commercial terms

(a) *Deposit*

Deposits of up to 50% are quite usual for the purchase of premises. They are usually paid right before the contract is signed or on the day of signing. However, in different circumstances the amount and the moment of payment may differ.

(b) *Timing*

Depending on the scale of a transaction and the complexity of legal mechanisms used in

the contract and in the transaction as a whole, the term may vary from a couple of weeks to several months or longer.

(c) *Employees*

Usually there are no direct consequences for the current owner's employees.

(d) *Warranties for construction of building*

It is not a usual practice for a contractor and consultants responsible for the construction of the building to provide warranties and guarantees to an incoming investor. Nevertheless, the incoming investor may be interested in the same level of guarantees as the previous owner. For this purpose, the incoming investor may ask for them to be included in the contract with the current owner.

It is notable that the analogues (albeit with their own peculiarities) of the representations and warranties have been introduced into Russian legislation in mid-2015. The owner can provide these to the investor if the latter wants to ensure that the building is in good order.

In case the premises have defects, the purchaser can claim for reduction of the price, or repairing it, or reimbursement of its costs for such repair. In case the defects are substantial, the buyer has the right to rescind the contract and claim the payments made.

(e) *Transfer of other tax or financial benefits*

The previous owner usually cannot transfer tax benefits to the investor.

Development

Practical points

(a) *Land ownership and assembly*

Development in Russia is generally possible when a developer has one of the two rights to the land plot:

- ownership; and/or
- lease for construction purposes (peculiarity of current Russian legislation).

To find out who is the owner of a particular land plot, one can approach the State Cadastre of Immovable Property (the Cadastre) and the Unified State Register of rights to immovable property and transactions therewith (the Register). Recently electronic systems have made available basic information on land plots via the internet, in the so-called "Public cadastral map", where cadastral borders of land plots are laid over the satellite maps. Most of the information can be ordered online, including an electronic copy of the abstract from both the Cadastre and Register, where information on the owner is provided in detail.

Land assembly is usually not easy in Russia, especially in big cities like Moscow or Saint-Petersburg. Therefore, the interest of developers is usually attracted by land parcels which already exist as one block of land, registered in the Register or belonging to one owner.

Moreover, one of the big issues developers need to consider if they participate in greenfield projects is the infrastructure. It often takes a lot of time and money to obtain the necessary permits and approvals for connection of the land parcel to gas, electricity and water networks.

One of the growing sectors of industry are so-called "industrial parks". The owner of an industrial park usually has several land plots, located near each other. In most cases the

category of land is prepared for industrial development, which is a very important factor, as changing the category of land (e.g. from agricultural to industrial) can be extremely difficult or even impossible. Industrial parks usually have a plan of development, infrastructure (electricity, gas, water, transport, etc.) and are located within the zones which are appropriate for development.

If such parks are registered and supported by the local government, industrial parks usually have tax benefits and a reduced burden of administrative procedures. For example, it is usually easier to obtain a construction permit or other approvals of local authorities.

Up to 92% of the land plots in Russia are owned by public authorities (federal, regional or municipal). There are special rules on how these can dispose of land. There has been a major reform of the Land Code of the Russian Federation, with numerous amendments having entered into force in March 2015. In principle, the land can be sold from the state to private owners based on the results of the auctions. If the land is acquired by a private investor for construction purposes, it is usually provided under a lease contract for a certain period of time (lease for construction purposes). If the tenant fails to build what he intended, he may lose the right to the land. After having finished the building, the tenant acquires the right to buy the land thereunder, at a price which is usually considerably lower than the market price.

(b) *Land transfer*

A developer can buy the land straight away, which is usually the case, but it is also possible to conclude a preliminary agreement or acquire an option to buy the land in the future.

The institution of options has been recently introduced into Russian legislation (although in fact it existed in practice even before that). Now the law expressly provides that options are valid and may be used as means to ensure that the party can claim for damages in case the other party breaches the agreement.

However, receiving the asset in kind may be difficult if the land has been sold to a third party. *For more detail, see 'Practical points', paragraph "a", above.*

(c) *Taxes and fees payable*

Purchasing land means that the owner will pay the land tax annually. The rate of the land tax varies in different regions and municipalities; it also depends on the category and permitted use of the land plot (up to 1.5% of the cadastral value of the land plot). After recent changes in the law, the tax base of the land tax (cadastral value of the land plot) is now growing, because the local authorities have the right to re-evaluate the land plots. In some municipalities, the cadastral value is now very close to the market price of the land, and the tax burden has become a significant factor for the owners of land.

Purchasing land requires registration in the Register, the state fee for the procedure being RUB 2,000 for natural persons (approx. €30) and RUB 22,000 (approx. €300) for legal entities.

Key commercial terms

(a) *Price*

The price of the land plot strongly depends on its legal background: whether it has been acquired by the previous owner in a legally correct way; have the documents been prepared in due form, etc. An important factor is that the land plot matches the needs of the investor from the standpoint of its legal status: land category and type of permitted

use. Local rules and acts of local authorities may influence the status of the land plot (e.g. city planning documentation may provide certain restrictions on future buildings, their parameters and usage). Due diligence is highly recommended before purchasing land and determining the purchase price as well as other terms of the contract.

(b) *Payment structure*

The payment structure depends on the agreement between the parties. Quite often, the investor asks for a delayed payment (or at least a part of it) to ensure that within a certain period of time the land plot will be in good order and no third party claims are brought against the new owner.

A previous landowner may ask for pledge of land (mortgage), pledge of shares of the investor (not very often used in practice), a bank guarantee, or a surety – to secure his right for payment.

(c) *Deal structures*

The simplest structure of the deal is a sale and purchase contract. In many cases it is supported by bank financing and therefore possibly a mortgage in favour of the bank. Forward fundings and forward-purchase structures are not very common, although they can also be used and are not prohibited by the law.

Another common way to develop the land is an investment contract, whereby each party may provide land, finances and works. These can be in various combinations on a legal basis of sale and purchase contract, contract for works, or a simple partnership contract. The finished building can be divided between the parties to the contract, or they may use monetary consideration in their relationship.

Apart from an asset deal, a share deal can also be considered as an option (*please see ‘Investment, Practical points’, paragraph “d” above*).

(d) *Taxes and fees payable*

There are usually no specific taxes or fees with respect to the situation when someone agrees to purchase or develop land, except those already mentioned in *‘Practical points’, paragraph “c”, above*, and *‘Investment, Practical Points’, paragraph “h”, above*.

Financing

Practical points

(a) *Level of loan*

The loan market in Russia is quite diversified; each lender has its own methods of calculating the level of loan applicable to a particular case to advance against commercial property. The approximate average level of loan is 75% to 95%; most often 80% or 85%.

(b) *Security*

Lenders usually require pledge of the financed assets (mortgage), which is registered in the Register and gives them maximum guarantee that in case of breach of contract by the borrower, the money will be returned or the assets sold, the money being transferred to the lender. The building (or a construction in progress) has to be listed in the Register for the mortgage to be registered.

If a natural person becomes an investor, and sometimes even when the company is a borrower, but the beneficiary is quite evident for the lender, the latter may ask for surety from the natural person. Shares of the company-investor can also be pledged as a security, but this type of security is not often used.

(c) *Lender due diligence*

In large-scale transactions, lenders may require professional due diligence, usually by well-known auditors. Lenders' banks may also inspect the documents by their own force.

(d) *Enforcement*

Several remedies are available to the lender in the event that the borrower has not complied with the loan contract. The most common are: suing the borrower for repayment of the debt; and exercising the rights of the mortgage holder (either acquiring possession of the pledged asset, or initiating its sale and using the proceeds of sale to pay off the loan).

According to the law, if the contract provides that the borrower shall return the loan in parts, the lender has the right to terminate the loan contract in the event that at least one of the instalments is not timely paid.

In this case, if the loan is secured, the lender usually has the right to ask for enforcement of the mortgage. However, unless the contract provides otherwise, the lender cannot ask for enforcement of pledge if the breach of the loan contract is minor (e.g. the overdue sum is 5% or less than the value of the pledged assets, or the delay is less than three months).

Key commercial terms

(a) *Length of loan*

Length of loan depends on the transaction and its scale. Secured loans of up to several years are quite common (5–7 years is the average approximate term, and is usually enough for the project to grow from the bare site to occupied premises).

(b) *Interest rate and payment dates*

One of the key factors in loan agreements in Russia is the possibility of currency rate change; therefore, loans can provide multiple scenarios for different types of rate change. At the same time large amounts of loans are provided in foreign currencies (EUR, USD, GBP).

Interest rates are usually connected with different external rates (e.g. LIBOR) and contracts provide the right of the banks to change the rate within a certain period of time under certain circumstances.

Payment dates are a matter of agreement between the parties.

(c) *Repayment*

In general, interest is paid on a monthly or annual basis, but in many cases it is included into the sum of loan and divided into several instalments, during which it is repaid together with a part of the capital of the loan. Alternatively, bullet repayment is possible, when all the capital is repaid on the expiration of loan date.

Breaking the terms of the contract may trigger the lender's right to demand full repayment of the loan (*please see 'Practical points', paragraph "d" above*).

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With his knowledge of German and English languages and European approach to business, Oleg has broad experience in virtually every area of law that foreign companies deal with when doing business in Russia. He has extensive practical experience in structuring M&A transactions. Oleg advised clients in German and Russian contract, corporate and investment law. In addition, Oleg represented interests of foreign companies and their affiliates in state courts and has experience in international commercial arbitration.

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Anton's core activity is representing both Russian and foreign companies in state courts and international commercial arbitration in corporate and contractual disputes and bankruptcy cases. Anton advises clients on the issues of Russian contract law, investment law (real estate), M&A transactions, and deal structuring and has experience in land and subsoil law.

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