

New Developments In Russian Legislation

Special Issue

COMMENT TO THE FEDERAL LAW #306-FZ OF 30/12/2008 "ON AMENDING SOME LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION IN CONNECTION WITH IMPROVEMENT OF THE PROCEDURE FOR EXECUTION AGAINST PLEDGED PROPERTY"

The RF Federal Law #306-FZ of 30/12/2008 "On amending some legislative acts of the Russian Federation in connection with improvement of the procedure for execution against pledged property" (hereinafter - the Law) makes changes to the Russian Federation Law "On pledge", the Federal Law "On mortgage", the RF Civil Code, the Federal Law "On insolvency (bankruptcy)", Basic Principles of the RF Legislation "On notarial profession" and some other acts.

The said Law was adopted to simplify the collecting procedure in respect of pledged property and the procedure of such property liquidation, as well as to establish some special modes of satisfying the creditor claims secured with the pledged property of the debtor, in case the latter becomes subject of bankruptcy proceedings.

Greater freedom to agreements between the pledger and the pledgeholder.

I. From now on, an extrajudicial agreement between the pledger and the pledgeholder with reference to execution upon the pledged property (hereinafter - Extrajudicial Execution Agreement) can be concluded *at any time* and could even be included in the pledge agreement. Earlier, such agreement could be concluded only after failure to execute or inadequate execution by the debtor of its obligation secured with the pledge.

However, if the said agreement is executed in respect of movable property, it requires a notarized consent of the individual (human) pledger to the extrajudicial procedure of execution upon the pledged property. In case of real estate, the notarized consent is mandatory regardless of whether the pledger is an individual or a legal entity.

In case such Extrajudicial Execution Agreement was not fulfilled, the execution could be enforced based on the notary's executive endorsement, unless otherwise provided by the law. The Basic Principles of the RF Legislation on notarial profession have been amended with the list of documents necessary to perform execution upon the pledged property. Thus, the said list has been raised to the level of the law, instead of being the subordinate legislation approved by the RF Government as it was earlier.

At the same time, the list of cases allowing execution upon the pledge *only based on the decision by the court* has been expanded. The added cases include situations where:

- the object of the pledge includes housing facilities belonging to individuals;
- the pledge agreement or another agreement between the pledger and the pledgeholder does not establish the order of execution upon the pledged personal estate or, according to the order as established by the parties, no such execution is possible;

Besides, the Civil Code provides an option for the law to define cases where execution upon the pledge is possible only based on the court decision. For example, the Federal Law "On Mortgage" stipulates that extrajudicial liquidation of the mortgaged property is impossible if that is a government or municipal property.

Green light to extrajudicial liquidation of the object of a pledge.

II. Changes in the object of a pledge liquidation procedure.

From now on, personal estate can be liquidated not only at an auction, but extrajudicially, too, based on commission agency contract. With their pledge agreement or Extrajudicial Execution Agreement, the parties (however, limited to legal entities and individual businessmen *only*) have the right to provide that:

- the object of a pledge is transferred to the property of the pledgeholder, or

- the pledgeholder has the right to sell the object of a pledge to the third party without auctioning, including based on commission agency contract, and to take the amount due from the proceeds.

Extrajudicial liquidation of any pledged securities circulating in the organized securities market can be carried out only via trading in the organized securities market.

To Law adds work to the appraisers. According to the legislation on evaluation activities, evaluation is *mandatory* whenever the pledged property is sold off the auction, including based on commission agency contract, or the pledgeholder decides to keep the object of a pledge, or the property to be liquidated belongs to a specially defined category (for example, the securities, which are not circulating in the organized market, with a number of exceptions; proprietary rights, except for the receivables not realized at auction; precious metals and jewels, etc.).

As for the real estate, the Law considerably reduced the timeframe for notification on real estate auctioning: the message on such auction should be placed not later than 10 days, but not earlier than 30 days prior to the auction (earlier, it was 30 days and 60 days accordingly). In addition to publication in the press, such message must be published on the Internet in the order as established by the RF Government.

Besides, the Law provides detailed procedure for liquidation of the pledged real estate based on agreement of the parties, including such liquidation's format – it must be an open auction (a closed auction is allowed only in the cases provided by the federal law), the order of sending to the pledger the notice reminding of its obligations and the notice of the auction, requirements to their content, publication of the auction ads in mass-media, the order of setting the initial sales price, the order of transfer of the property to the auction winner, etc.

The law also prescribes the procedure of carrying out a public auction: the starting auction price, the order of the secondary auction, reduction of price, etc.

Execution rejected.

III. The legislation provisions concerning the grounds for refusal in execution upon the pledged property have been amended. Earlier, execution upon the pledged property was not allowed if the debtor's default on its obligation secured with the pledge was *extremely insignificant*. However, what such extremely insignificant infringement meant was not defined being left, as a matter of fact, subject to the court opinion. Now, the said blank spot has been eliminated. Infringement is deemed extremely insignificant and the amount of the pledgeholder's claims is considered obviously disproportionate to the value of the pledged property if the following conditions are observed *simultaneously*:

- 1) the amount of the defaulted obligation is less than five percent from the amount of the object of the pledge evaluation as stated in the pledge agreement;
- 2) the overdue period in respect of the obligation secured with the pledge is less than three months.

The rule of possible execution upon the pledged property (unless the pledge agreement provides otherwise) in respect of the obligation executed as periodic payments, in case of regular infringement of such payments timeframe (i.e. three times within 12 months irrespective of insignificance of each delay) has been transferred from the Federal Law "On Mortgage" to the Civil Code of the Russian Federation. Thus, the said norm became the *common* one and is applicable both in respect of immovable, and movable property henceforth.

Clearer picture for pledge creditors.

IV. Besides the aforesaid amendments, the Law clarifies the status of those creditors whose claims are secured with the pledged property of the debtor, in case the latter becomes subject of bankruptcy proceedings.

During the observation period such creditors have no right to execution upon the pledged property in extrajudicial order, but they have the right to vote at general meeting of the creditors.

During financial rehabilitation or external management:

- they can demand liquidation of the object of a pledge through court and satisfaction of their claims from the proceeds (unless the debtor proves that liquidation of such debtor's property will make restoration of its solvency impossible);
- or they can give up the execution upon the pledged property in this procedure and get their vote at general meeting of the creditors from the moment of the receipt of such refusal by the insolvency officer.

Besides, the Law established *the order of distribution of the proceeds* from liquidation of the object of a pledge within the limits of bankruptcy proceedings:

70% of the proceeds but no more the amount of debt and interest due are transferred to the pledgeholder, 20% go to satisfy claims of the creditors of the first and the second tier, while the leftovers are used to make current payments.

If the pledge secures obligations under the credit agreement, than 80% of the proceeds go to repay the creditor's claims.

The law has become effective on 11.01.2009.

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