

Foreclosure Rights of Secured Creditors in Russia

Recent legislative amendments provide secured creditors with more enforcement options

On December 30, 2008 a series of amendments (the Amendments) to the Civil Code, the Land Code, Federal Law No. 2872-I (On Pledges), Federal Law No. 102-FZ (On Mortgages) and Federal Law No. 229-FZ (On Execution Proceedings) took effect. The amendments suffer from certain internal contradictions and ambiguity that we expect will generate significant litigation before we get a clear picture of how the law will be applied. But the amendments have the laudatory effect of providing more options for secured lenders to realize on their collateral and possibly reduce the administrative costs and time frame associated with foreclosures.

Prior Foreclosure Process

Prior to the introduction of the amendments, a secured creditor desirous of exercising against its collateral was mostly limited to a cumbersome judicial foreclosure process, which required a public auction of the collateral and generally speaking could not be completed in less than six months (if all went well). The secured creditor had very limited control over the foreclosure procedure once initiated.

Mandatory Court-Supervised Foreclosures

The law still requires that foreclosure must be effected under court supervision in the following circumstances:

- the pledgor is a natural person and third-party consent is required for the pledge to be effective;
- the pledged property is residential premises owned by a natural person;
- the pledged property is of historic or artistic value;
- the pledged property is state or municipal property;
- the pledgor cannot be located; or
- the operative contract does not provide for another form of foreclosure.

Court-Supervised Foreclosure Procedures

A court-supervised foreclosure requires a public auction of the collateral with the minimum opening bid established by the court and the highest bid prevailing. Upon request of the pledgor, the court may postpone a

sale for up to one year, provided it finds that such a delay shall not significantly increase the risk of loss to the secured party.

Public sales must be performed within two months from the moment the organizer of the public sale receives appropriate instructions from the bailiff.

A public sale will fail if (i) there are fewer than two bidders; (ii) there are no bids higher than the court-established minimum bid; or (iii) the winning bidder fails to timely close the purchase. *In the event of a failed public sale, the debtor and the secured creditor may enter into a sale with the secured creditor offsetting its claim against the purchase price.* If the debtor and the secured creditor do not agree on a credit-bid sale, a repeated auction must be held within one month of the prior auction being declared void by the court. The minimum opening bid at the second auction shall be reduced by 15 percent. If the second auction fails to produce a sale, the secured creditor may purchase the collateral at a price no less than 10 percent of the minimum opening bid at the second auction (i.e., no less than 25 percent of the original minimum opening bid), again crediting its claim against the purchase price. If the secured creditor does not avail itself of its rights to purchase the collateral, its lien shall be deemed canceled.

The secured creditor shall have an unsecured deficiency claim if the sale fails to generate sufficient proceeds to satisfy its secured claim in full.

Out-of-Court Foreclosures of Personal Property

Out-of-court foreclosures are permissible provided the debtor and its secured creditor have agreed to such a process. If the debtor is a natural person, his or her consent to such an agreement needs to be notarized. Legal entities and individual entrepreneurs now may agree to an out-of-court foreclosure process in situations in which:

- the debtor transfers the collateral to the secured creditor in lieu of foreclosure (strict foreclosure); or
- the secured creditor conducts a public sale or a private sale through a commissioned agent.

Strict Foreclosures

Strict foreclosures may be agreed to only by legal entities and individual entrepreneurs in connection with business debts. Any property retained by the secured creditor must be valued by agreement. In certain cases, a third-party appraisal is required.

Best practices suggest that a secured creditor should obtain an independent third-party appraisal from a reputable appraiser at any time that collateral is retained, particularly if the secured creditor wants to retain a deficiency claim. Otherwise, the transfer may be challenged as undervalued, with the alleged excess value avoided as an illegal gift between commercial entities or as a voidable undervalued transaction (constructive fraudulent transfer) in the event of bankruptcy of the debtor.

Sale Through Commission Agent

The sale of the property may be performed through a commission agreement pursuant to which the proceeds equal to the secured creditor's claim are to be transferred by the commission agent to the secured creditor after reduction for costs and expenses, subject to the debtor's rights to receive any amounts exceeding the secured creditor's claim.

The commissioned agent may be chosen by the parties in the mortgage documentation or by the secured creditor. The sale price shall be equal to the market value of the property.

Out-of-Court Public Sales

The initial selling price at an out-of-court public sale may be determined in accordance with the security agreement or a separate out-of-court foreclosure agreement, unless the law requires a third-party appraisal, in which case the initial selling price shall be no less than 80 percent of the appraised value unless the out-of-court foreclosure agreement provides otherwise. The parties may set their own deadline for timing of public sales in their agreement and are not bound by the two-month requirement applicable to court-supervised sales.

A third-party appraisal is required if the collateral consists of (i) nonpublicly traded securities, (ii) interests in property (such as lease right, easement, etc.), (iii) precious metals and gems, (iv) numismatic bills and coins, (v) objects of historical and artistic value or (vi) property whose stated value exceeds 500,000 rubles. Accordingly, a third-party appraisal effectively is required to foreclose on most collateral due to the low value of the threshold (500,000 rubles).

Publicly traded securities must be handled through the trade administrator of the applicable exchange.

Procedures for Out-of-Court Foreclosures

Generally, the procedures for out-of-court foreclosures resemble those established for public sales pursuant to a court order. It appears that new amendments will provide parties more flexibility in determining specifics of the sale of pledged property.

Out-of-Court Foreclosures of Real Property

Out-of-court foreclosures of real property may be achieved by an out-of-court foreclosure agreement, which may provide for the acquisition of the collateral by the mortgagee either for its own use or for sale to a third party. The foreclosure of real property requires a notarized approval of the out-of-court foreclosure agreement by the mortgagor. Alternatively, the real property may be foreclosed and sold at a public sale. Procedurally, a secured creditor must send the debtor a notice containing the following information to effect an out-of-court foreclosure:

- the amount to be paid, or deemed to be paid if collateral is retained, by the secured creditor;
- a proposal to perform the secured obligation; and
- a notice that if the secured obligation is not performed, the mortgagee shall be entitled to foreclose the real property.

Unless a longer period is required by law or agreement of the parties, the sale shall be completed within 10 days of the debtor's receipt of the notice, or 45 days after sending of the notice.

Caveat

This Guideline is intended only to provide a general overview of the issues covered. Accordingly, legal advice should be obtained with respect to your unique facts and circumstances.

For More Information

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