DLA PIPER

LEGAL ALERT

AMENDMENTS TO THE CIVIL CODE OF THE RUSSIAN FEDERATION

EFFECTIVE FROM 1 JULY 2014

PART 1 OF THE CIVIL CODE OF THE RUSSIAN FEDERATION

A further set of amendments to the Civil Code of the Russian Federation ("Russian Civil Code"), introduced by Federal Law No. 367-FZ *On Amendment of the First Part of the Civil Code of the Russian Federation and Recognition of Certain Legislative Acts (and their Provisions) of the Russian Federation Invalid* dated 21 December 2013, becomes effective on 1 July 2014 and the old Law on Pledge 1992 becomes inoperative.

The new amendments to the Russian Civil Code will only apply to legal relationships that emerge after 1 July 2014 and, as usual, do not affect rights and obligations that existed before.

Some amendments are aimed at structuring or clarifying the existing provisions, however there are some provisions which have not previously been set out in Russian civil laws.

The principal amendments are covered in this overview below.

I. AMENDMENTS TO LAWS ON PLEDGE

As a matter of structure, provisions governing pledge relationships consist of general and special provisions.

1. General provisions on pledge

1.1. Pledged item

- proprietary rights and rights under an obligation are expressly specified as the pledged item;
- a pledge can be created not only over a thing itself, but also over profit generated as a result of the use of the pledged property and over property which can be given to the pledgor in exchange for the pledged property in case of its loss or on grounds set out by law, including insurance compensation, compensation provided in exchange for the pledged property, and income generated from the use of the pledged property by third parties, etc. Such property can be reclaimed by the pledgor directly, ie straight from the third party who is obliged to provide compensation;
- either all the pledgor's property or a part of it (from 1 January 2015) and property of a special kind or type can be the pledged item (before the amendments it was only permitted to specify property of a special kind or type for an inventory pledge);
- property to be created/purchased in the future can be a pledged item. However, in this case the pledge cannot be created before the right to such property arises.

1.2. Creation of pledge

- if a pledge is created by virtue of law, it is provided that relationships between the pledgor and pledgee can be regulated by a pledge agreement;
- under law it is necessary to obtain an approval to pledge property if such approval is required for the property to be disposed of. The exception in this case is a pledge created by virtue of law.

1.3 Pledge terms and conditions

- in order to set out obligations pertaining to the primary obligation, it is enough to make a reference to the agreement giving rise to such an obligation which enshrines the standard practice in law;[1]
- pledgors who carry out entrepreneurial activity may secure by pledge both future obligations and any and all obligations to the creditor (without going into details) capped by a specific amount;
- the cost of the pledged property is no longer a material term of a pledge agreement;
- as a general rule, any change to the market value of pledge does not modify or terminate it (before the amendments the parties were to expressly stipulate the corresponding terms and conditions in the agreement);
- the pledgor must notify the pledgee of any and all rights to the pledged item he/she is aware of, otherwise the pledgee may demand the early performance of the obligation secured by the pledge.

[1] Resolution No. 8 of the Plenum of the Supreme Court of the Russian Federation *On Certain Issues Related to the Application of the First Part of the Civil Code of the Russian Federation* dated 1 July 1996, clause 43.

1.4. State registration of a property pledge and keeping records on such

- a pledge is subject to state registration if: (i) rights allocating property to a specific person are also subject to registration (a mortgage, for example) and (ii) the pledged item is the rights of a member to a limited liability company;
- a movable property pledge, save for the pledge of rights of a member of a limited liability company, a securities pledge, or a pledge of rights under a bank deposit agreement can be reflected in the electronic register of a movable property pledge notice;
- recording a movable property pledge is not considered state registration; it is carried out voluntarily and does not affect the validity of the pledge agreement, however the pledgee may refer to the pledge in his/her relationship with third parties only upon a record being made in the register (save for cases when a third party knew or should have known about such a pledge);
- movable property is recorded by a notary subject to notary laws by means of the registration of pledge notices in the register; at the same time both the pledgor and the pledgee are entitled to file such a notice. Amending a pledge record or striking it from the register is made subject to the pledgee's application or, if he/she fails to do so, upon a court decision;
- forms of movable property pledge notices for different situations (in particular, if a pledge arises or is terminated by virtue of law) are approved by order No. 127 of the Russian Ministry of Justice of dated 27 July 2013;
- the former procedure for the pledgor to maintain pledge books has been abolished;
- a pledgee whose pledge was registered in the register on an earlier date has priority when demands are satisfied out of the pledged property;
- information from the property pledge notice register is available on the website https://www.reestr-zalogov.ru

1.5. Bona fide pledgee concept

- the concept of a *bona fide* pledgee was introduced; according to it a bona fide pledgee is a person in favour of whom the property was pledged by a person who is neither owner, nor somebody duly authorised to dispose of the property and such pledgee did not and should not have had any reason to know about this;
- legal relationships with a *bona fide* pledgee are regulated according to a *bona fide* purchaser model, ie a bona fide pledgee preserves a pledge right to the property save for situations when such pledged property before its pledge: (i) was lost by the owner or the person to whose possession it was delivered, (ii) was stolen or (iii) otherwise withdrawn from the possession of the persons beyond their will. In the foregoing situations the pledge is to be terminated;
- the new amendments enshrine the rule of the termination of a pledge upon the acquisition of the pledged property by a *bona fide* purchaser shaped by court practice[2].

1.6. Priority of pledges and subsequent pledge

- the concept of a co-pledgee has been introduced; co-pledgees mean those enjoying rights of equal priority to the pledged item, including joint and several creditors or those entitled to a specific share under the same obligation and independent creditors under different obligations;
- the priority of pledges and the procedure for distributing proceeds generated from the sale of the pledged item can be changed upon agreement of the pledgees (regardless of whether the pledgor is a party to such an agreement);
- when the priority of creditors is determined it is assumed that earlier claims have a higher priority. However, the pledgee's claim with an earlier record will always prevail.

  As an exception, the priority of claims of the pledgees arising out of movable property pledge agreements concluded before 1 July 2014 and recorded in the register of movable property pledge notices from 1 July 2014 until 1 February 2015 is to be determined taking into account the date of the conclusion of such pledge agreements;
- when it is impossible to establish the priority of pledges, claims are to be satisfied pro rata to the amount of secured obligations;
- a pledgor must notify all the preceding pledgees of a subsequent pledge;
- the right to prohibit subsequent pledges in a pledge agreement is excluded. However, rights of the parties to determine the terms and conditions on which the pledgor is entitled to enter into a subsequent pledge agreement are permitted.
- entering into a subsequent pledge agreement in breach of the terms and conditions provided in the preceding pledge agreement entitles the preceding pledgee to claim compensation of losses from the pledgor. At the same time if the pledgee under the subsequent agreement knew or should have known about such a breach, claims of such pledgee to the pledgor should be satisfied subject to the terms and conditions of the preceding pledge agreement;
- it is determined that the subsequent pledgee is entitled to (i) claim the early performance of obligations secured by the subsequent pledge if execution is levied on the pledged property by the preceding pledgee, and (ii) levy execution on the pledged property simultaneously with such preceding pledgee. Such right of the subsequent pledgee can be restricted in the preceding pledge agreement;
- if property left after execution levied by the preceding pledgee is insufficient to satisfy the claims of the subsequent pledgee, the subsequent pledge will be terminated if: (i) the subsequent pledgee does not exercise his/her right to levy execution on the pledged property together with the preceding pledgee, or (ii) in the subsequent pledge agreement the right of the subsequent pledgee to claim the early performance of the obligation secured by the subsequent pledge is restricted.

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[2] Resolution No. 10 of the Plenum of the Higher Arbitrazh Court On Some Aspects of Application of Pledge Laws dated 17 February 2011, clause 25.

1.7. Levying execution and the sale of the pledged property

- the possibility of selling pledged property on an out-of-court basis has been confirmed; the law determines that upon the pledgor's request the court may terminate the levy of execution on the property on an out-of-court basis and make a decision on to levy execution through a public auction if the rights of the pledgor are breached or there is a substantial risk of such a breach;
- requirements are set for the content of agreements with respect to levying execution on the pledged property on an out-of court basis which are to include: (i) a reference to one or several pledged property sales procedures (before the amendments, a reference to the sales procedure was optional) and (ii) initial sale price of the pledged property or procedure for its determination;
- an exhaustive list of the pledged property sales procedures has been compiled; other methods of levy may apply to special types of pledge;
- when the pledged property is sold the pledgee must assume measures in order to ensure maximum proceeds from the sale of the pledged item;
- a list of cases when execution can be levied on residential premises under a court decision has been specified in more detail;
- upon an agreement between the pledgor and pledgee, pledged property not relating to real estate can be sold at a second auction on an out-of-court basis by means of a consistent reduction of price from the level of the initial sale price set at the first auction.

1.8. Pledge management agreement

- if the performance of an obligation secured by a pledge is connected to entrepreneurial activity, rights and obligations of the pledgee can be exercised by a manager under a pledge management agreement;
- under such an agreement the manager acts on behalf and in the interests of all the creditors, and the creditors may not independently exercise their rights and obligations as the pledgees while such an agreement is effective;
- the creditors shall compensate the manager for his/her expenses and pay remuneration;
- an agreement with the pledge manager can be entered into both before and after the conclusion of the pledge agreement;
- to the extent not regulated by the provisions of the Civil Code on pledge management agreements, a pledge management agreement shall be regulated by the rules on suretyship agreements;
- the law provides for a possibility for the pledgee to terminate the pledge management agreement unilaterally.

2. Special provisions on pledge

2.1. Real estate pledge (mortgage)

- a mortgage is still subject to state registration, however mortgage agreements concluded after 1 July 2014 are not subject to state registration;
- the law may provide for a non-accessory real estate pledge: for example, a mortgage shall be deemed created, shall exist and shall be terminated irrespective of the creation, existence and termination of the obligation secured by it.

2.2. Inventory pledge

- requirements for the description of the item pledged under an inventory pledge have been abrogated;
- the pledgee's right to notarise the availability of the pledged property in a given place at a given time has been established.

2.3. Pledge of right under an obligation (claims)

- a pledge agreement shall contain information on the pledgor's debtor, an obligation out of which the pledged right arises, and the party to the pledge agreement who shall keep original documents confirming the right being pledged;

  However, it is assumed that original documents confirming the right being pledged shall be kept by the pledgee;
- it is prohibited to perform a primary obligation early in the event of the termination of the pledged claims due to the expiry of their validity period;
- some restrictions have been established for rights to conclude those pledge agreements the breach of which, however shall not result in such a pledge being invalid and may not serve as a ground for termination of the pledge agreement;
- the procedure for the performance by the pledgor's debtor of his obligations under the pledged claim has been determined;
- it is provided that the pledgor's debtor may credit funds to a special pledge account of the pledgor and the claim in respect to such an account is also pledged in favour of the pledgee.

2.4. Exclusive rights pledge

- an exclusive rights pledge is determined as an individual pledge type;
- as a general rule, the general provisions on pledge apply to an agreement with respect to a pledge of an exclusive right to an intellectual activity result or a means of individualisation, while the rules governing pledge of rights under an obligation apply to an agreement with respect to the pledge of rights provided by an agreement on the alienation of exclusive rights or a licence agreement.

2.5. Pledge of rights under a bank account (deposit) agreement

- the possibility of pledging rights under a bank account (deposit) agreement has been introduced;
- a bank will open a pledge account for the pledgor and rights to such an account will be pledged in favour of the pledgee;
- as a general rule, the pledge shall be created over all the funds on the pledge account. The parties may define a limit which the amount of funds on the pledge account must not fall below;
- the pledge is created at the time of the notification of the bank on the pledge of rights to the account (deposit) and the provision of a copy of the pledge agreement to the bank;
- as a general rule, the pledgor may freely dispose of funds on the account save for the restrictions set out in the Russian Civil Code;

- joint and several liability to the pledgee has been provided in some cases;
- a special procedure for selling pledged rights has been established: levying execution on the rights pledged under such an agreement (both in court and on an out-of-court basis) shall only be made through the bank withdrawing funds from the pledgor's pledge account on the basis of the pledgee's instruction and giving them (or transferring them) to the pledgee.

2.6. Pledge of rights to participate in legal entities

- the law, *inter alia*, structures and introduces a number of new institutions regulating pledge over shares and participatory interests in the charter capital of joint stock and limited liability companies, and prohibiting pledge of rights of participants of other legal entities;
- one of the most essential novelties is a distinction made in law between a pledge of a title to shares and participatory interests and a pledge of the rights to participate attached to such shares and interests. As a general rule, share pledge rights attached to shares are exercised by the pledgor (shareholder), while pledge of participatory interests are exercised by the pledgee;
- previously Russian laws have not expressly provided for the pledge of rights of participants which, in the absence of special qualifications in the pledge agreement, were still exercised by the pledgor from the time of the creation of pledge over the property[3]. However, from 1 July 2014 the law expressly provides for a possibility to stipulate in the pledge agreement the terms and conditions on which rights of participants in the charter capital of economic undertakings can be exercised both by the pledgor and the pledgee;
- the law does not define "*rights of participants (founders)*" nor specifies the scope of their authorities and the ratio between such rules and general rules regulating the pledge of rights which also becomes effective from 1 July 2014. This term seems to include, above all, corporate rights attached to shares and participatory interests, for instance, a right to attend and vote at the general meeting, receive information on the company's activities, etc and represent a special institution of pledge over rights having priority over general rules on the pledge of rights. Nevertheless, more detailed findings on subsequent developments and judicial interpretation of those novelties can be made after corresponding enforcement practice is developed and the potential amendment of the joint stock companies and limited liability companies laws; the drafts amendments to such are not yet ready;
- the law sets out a number of special rules related to securities pledge which, in particular, are applicable to share pledge agreements. For example, if rights attached to the pledged securities are exercised by the pledgor, the pledge agreement may provide for the pledgor's obligation to coordinate his/her actions aimed at exercising his/her rights with the pledgee. A breach of this obligation shall give rise to the pledgor's liability and afford the pledgee the right to claim the early performance of the obligation secured by pledge. It is still unknown whether this right to unilateral termination can be exercised if the other party does not agree to such termination and what type of evidence for the pledgor's default are deemed valid by court. It is still an unanswered question as to which extent similar consequences may apply to a participatory interest pledge agreement if a termination agreement thereto is to be notarised in the same way as the principal agreement;
- the law also states that a security pledge agreement may provide that the pledgee may exercise all the rights attached to the pledged security, expressly stipulating that a right to gain income on the security can be stricken off from the list of rights exercisable by the pledgee. However, it is still unclear whether it is possible to provide in the agreement a right to gain income where and to the extent such rules may cover relationships related to the pledge of participatory interests which do not constitute securities;
- when the pledged securities are being converted into other securities or other property, such securities or such property are/is deemed pledged in favour of the pledgee, unless otherwise provided by the pledge agreement;
- in addition to the abovementioned outstanding questions, the law also does not address the following issues:
  - whether the pledgee is entitled by virtue of the pledge agreement to participate in the general meetings of the participants/shareholders, since effective corporate laws, as a general rule, provide that such rights are to be enjoyed only by the participants/shareholders or their representatives, but the law stipulates that the pledgee exercises the foregoing rights in his name, ie without a power of attorney issued by the participants/shareholders;
  - whether provisions of the agreement with respect to exercising the pledgor's rights are subject to the restrictions established for concluding a corporate agreement in order to secure protected interests of the pledgee in accordance with new provisions of the Russian Civil Code;
  - whether the conclusion of a pledge agreement providing that the pledgee is to exercise rights to participate serves as a ground to consider that such person is afforded *a right to dispose* of a specific number of votes in the charter capital of a legal entity and, as a consequence, a ground for such transactions being approved by FAS (subject to other criteria) and/or having a notice filed with the Central Bank (subject to other criteria) and other state authorities.
- as noted above, such provisions involving the pledge of rights to participate are applicable to the relationships between the parties which arose after 1 July 2014 and, as a general rule, should not cover pledge agreements concluded before this date. However, there are conservative approaches substantiating the applicability of new features relating to pledge agreements that have already been concluded with a risk of transferring

[3] Until now court practice was quite inconsistent; on the one hand it provided that rights of participants can be pledged, for example, a right to attend and vote at the general meeting (see: Ruling No. BAC-3038/09 of the Higher Arbitrazh Court of the Russian Federation dated 20 March 2009 with respect to case No. A 21-7628/2007), on the other hand it is not permitted to pledge rights to participate in case of pledge over shares or interests as such, considering rights to participate as non-disposable personal non-proprietary rights (see: Resolution No. A74-2127/03-K1-Ф02-762/04-C2 of the Federal Arbitrazh Court for the Eastern-Siberian District dated 8 April 2004, Ruling No. BAC-3038/09 of the Higher Arbitrazh Court with respect to case No. A21-7628/2007 dated 20 March 2009).

rights to the pledgees (for example, to crediting banks). For the avoidance of potential problems we recommend reviewing the existing interest pledge agreements and, if necessary, introducing terms and conditions related to the pledgor exercising the participant's rights.

2. SUBSTITUTION OF PERSONS IN AN OBLIGATION. KEY CHANGES

These changes are not new in many respects: they either make already existing provisions of chapter 24 of the Russian Civil Code more concrete and detailed or enshrine in the legislation the provisions that were shaped by court practice or covered in other chapters and sections of the Russian Civil Code.

Here are the main developments:

1. Restrictions on the assignment of a claim

1.1. Assignment of a claim with the debtor's consent

- as a general rule, assigning a creditor's rights to another person does not require the debtor's consent. However, according to the newly amended and restated Russian Civil Code, a debtor's consent is required in relation to the assignment of the right to receive non-monetary performance if such assignment renders the obligation significantly more burdensome for the debtor or if such assignment is restricted or prohibited by an agreement between the creditor and debtor;
- an assignment which is made without the consent of the debtor, who is an individual, and which results in costs for the debtor brings about a joint obligation for the original creditor and the new one to reimburse the debtor for such costs (unless otherwise provided by laws on securities).

1.2. Prohibition of assignment

- a provision has been enshrined in the law to the effect that an agreement prohibiting or restricting the assignment of a claim with respect to a monetary obligation relating to the conduct of entrepreneurial activity by the parties thereto does not render such assignment void and may not serve as a ground for rescinding the contract that gives rise to the obligation being so assigned. The creditor in this case remains liable towards the debtor for the breach of the prohibition or restriction on the assignment.

1.3. Restrictions on the partial assignment of a claim

- the law has enshrined a provision that was earlier shaped by court practice (cl. 5 of Information Letter No. 120 of the Presidium of the Higher Arbitrazh Court of the Russian Federation dated 30 October 2007, Ruling No. 8955/00 of the Presidium of the Higher Arbitrazh Court of the Russian Federation dated 18 December 2001, and Ruling No. 3764/01 of the Presidium of the Higher Arbitrazh Court of the Russian Federation dated 25 December 2001): as a general rule, partial assignment of a claim with respect to a monetary obligation is permitted unless otherwise provided by law;
- assignment of a claim with respect to non-monetary performance is impossible if the obligation is indivisible and if partial assignment creates additional burdens for the performance of the obligation by the debtor.

1.4. Assignment of a joint creditor's claim with the consent of other creditors

- a rule has been introduced to the effect that assignment of a claim by a joint creditor to a third party is possible with the consent of other joint creditors unless otherwise provided by the agreement of the creditors.

1.5. Requirements towards the assignment of claims

- when assigning a claim, the assignor must comply with the following terms and conditions (additional requirements may be stipulated by law or contract):
  - the claim being assigned exists at the time of the assignment unless this claim is a future claim;
  - the assignor is authorised to make the assignment;
  - the claim being assigned was not earlier assigned by the assignor to another person;
  - the assignor did not and will not take any action which may serve as grounds for the debtor's objections against the claim so assigned.
- a right has been established for the assignee to demand restitution of all that was assigned under an assignment agreement and reimbursement of damages from the assignor if the assignor fails to comply with the conditions set out above, if the claim assigned is void or if the debtor defaults on the obligation guaranteed by the assignor;
- if the assignor assigns one and the same claim to several persons, the claim is deemed to have been assigned to the person to whom such assignment was made earlier. In this case the risk ensuing from the consequences of the debtor's performance towards another assignee lies with the assignor or assignee who knew or should have known of the assignment of the claim that took place earlier.

2. Assignment of a future claim

- Chapter 24 of the Russian Civil Code has been amended to include Article 388.1 concerning the assignment of a claim under an obligation which will arise in the future (a future claim) if the assignment is made on the basis of a transaction relating to the conduct of entrepreneurial activity by the parties to the transaction. Formerly the assignment of a future claim had to be substantiated pursuant to cl. 4 of Information Letter No. 120 of the Presidium of the Higher Arbitrazh Court of the Russian Federation dated 30 October 2007.

3. Assignment of debt

3.1. Debt assignment form

- the newly amended law provides for the assignment of debt from the debtor to another person under an agreement between the creditor and the new debtor in the case that the obligations are associated with the conduct of entrepreneurial activity.

3.2. Creditor's consent to the assignment of debt

- the existing provision on the assignment of debt by the debtor to another person only with the consent of the creditor has been clarified. A provision, earlier shaped by court practice (the Ruling of the Federal Arbitrazh Court for the Moscow Region of 22 June 2012 with respect to case No. A40-56483/11-4-277, the Ruling of the Federal Arbitrazh Court for the Western-Siberian

District of 24 July 2013 with respect to case No. A81-2017/2012), to the effect that in the absence of creditor's consent assignment of debt shall be void has been written into the law;

- the creditor may give prior consent and then the assignment shall be deemed to take place the moment the creditor receives notice of debt assignment.

3.3. New debtor's and creditor's rights

- Article 392, entitled New Debtor's Objections against Creditor's Claims, has been restated to include a provision to the effect that a new debtor may not exercise the right to set off a counterclaim, which was available to the original debtor, against the creditor.

3.4. Contract assignment

- Article 392.3 of the Russian Civil Code introduces a new term "contract assignment", which encompasses the formerly used notion of assignment of rights and responsibilities under a contract to another person.

PART 2 OF THE CIVIL CODE OF THE RUSSIAN FEDERATION

- Federal Law No. 379-FZ of 21 December 2013 *On Amending Certain Legislative Acts of the Russian Federation* entered into force on 1 July 2014. The law introduces amendments and modifications to part 2 of the Russian Civil Code.

1. New types of agreements are introduced: a nominee account agreement and an escrow account agreement

1.1. A nominee account

- may be opened to an account holder for the purpose of making transactions in monetary funds, the rights to which are held by another person: the beneficiary;
- the suspension of transactions in a nominee account, or the attachment or withdrawal of monetary funds held in the account off the account are not permitted (except for cases of crediting the account and/or except when the obligation to pay for the banking services is stated in the nominee account opening agreement);
- the attachment or withdrawal of monetary funds from such an account against the beneficiary's obligations may be performed by virtue of a court order or in other cases as stipulated by law or the nominee account agreement.

1.2 An escrow account

- is opened by the bank (escrow agent) for recording and blocking monetary funds received from the account holder (depositor) with a view to transferring them to another person (the beneficiary) when grounds to do so arise under the agreement between the bank, depositor and beneficiary.

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