INSOL INTERNATIONAL

TREATMENT OF SECURED CLAIMS IN INSOLVENCY AND PRE-INSOLVENCY PROCEEDINGS II

INSOL INTERNATIONAL

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PRESIDENT'S INTRODUCTION

Banks and other lending institutions will extend credit provided they can obtain effective security in the event of default. This results in the lender being assured that it has the right to recover its debt in a quick and efficient manner.

When a borrower defaults under a loan agreement, the lender is usually unaware of the extent of the debtor's financial difficulties. There is always a risk that the debtor may be unable to repay other creditors in addition to the lender and be forced into insolvent liquidation proceedings.

Unsecured creditors usually receive very little or nothing through the rateable distribution process employed in such proceedings. However, in most jurisdictions secured creditors stand outside the insolvency proceedings and the credit instruments would give the lender the ability to enforce its rights without utilizing the courts. A secured creditor also has the right to pursue recovery as an unsecured creditor for any balance of the debt which the security does not satisfy.

In June 2007 INSOL published the first edition of this book. The subject matter continues to be of interest and relevance to practitioners and, as a result, the INSOL Technical Research Committee decided that a second edition of this book should be published. INSOL International is delighted to present this new and updated 20 chapter book which includes seven new country chapters (namely, Brazil, BVI, Cayman Islands, Hong Kong, Mexico, Nigeria and Singapore) and 13 updated and revised chapters of previously included countries. The chapters cover a wide range of key issues that practitioners would find useful, including the types of security rights that are available, the enforcement of such rights, circumstances when the granting of secured rights may be challenged and declared void, and the impact of reorganisation of a company on secured creditors, to name but a few.

The project was led by Evan C Hollander of Orrick, Herrington & Sutcliffe LLP, New York. Evan was also involved in the publication of the 1st edition of this book and we are very grateful for his guidance, interest, and ongoing commitment to publish this book to a very high standard. Evan had a great team working on this project and we are indebted to all of them for committing their time to the editing and review process. We would also like to thank the contributors for taking the time to write / update these chapters, despite their busy schedules.

Julie Hertzberg
President
INSOL International

FOREWORD

Consistent with INSOL's mission statement to "facilitate the exchange of information and ideas", the Technical Research Committee first produced in 2007 a comparative study of the treatment of secured claims in pre-insolvency and insolvency proceedings. The template utilized in the prior edition of this guide, developed with the assistance of my predecessor Andrew DeNatale Of Counsel and Head of the Special Situations Lending Group at Stroock & Stroock & Lavan, provided a handy, accessible and well-organized reference tool outlining the issues impacting the enforcement of secured claims in the twelve jurisdictions covered in that edition. Thus, that template has been incorporated with slight modification into this new edition covering the laws in 20 jurisdictions.

The treatment of secured claims is a matter that insolvency practitioners address in virtually every case in every jurisdiction. This new volume clearly illustrates the advantages and limitations of secured status in in pre-insolvency and insolvency proceedings in each of the 20 jurisdictions covered. As more corporations have extended their presence across borders, it has become critical for practitioners and investors to understand the nuances of the treatment of secured claims in multiple locations. It is the Committee's hope that this study will enable practitioners to navigate the complexities that arise in multinational restructurings, and to provide investors with a handy guide for sound practical information regarding the risks and rewards of secured investments in different countries.

The project would not have been possible without the help and support of others. The initial acknowledgement must go to the Technical Research Committee for developing the concept and format of the project, and to my predecessor who oversaw the production of the prior edition of this volume. I also extend my thanks to the contributors, each of whom submitted excellent material for the jurisdictions covered by the project. Finally, I would like to extend my sincere gratitude to my colleagues, Scott Morrison, Vincent Yiu and Nicholas Sabatino for assisting in the editing of the chapters in this volume and Emmanuel Fua, Peter Amend and Monica Perrigino, who assisted in drafting the materials on the United States.

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CONTENTS

RUSSIA

1. Briefly summarise the types of security rights available and indicate, in each case:

- ***What are the common forms of security rights taken in respect of movable or personal property, including the taking of a pledge, lien, retention of title, fixed or floating charge?***
- ***What are the common forms of security rights taken in respect of immovable or real property, including the taking of a mortgage, lien or privilege?***
- ***Is the security interest granted by law, contract or both?***

The Civil Code provides for several forms of security rights in respect of property, including pledges and liens. Retention of title and other title-based security arrangements are also available.[1]

1.1 Pledge

A pledge creates a security over property, shares, contractual and intellectual property rights and other types of assets. The benefit of having a pledge is that, if a debtor fails to perform or improperly performs a secured obligation, the pledgee is entitled to obtain satisfaction from the value of the pledged assets in priority to other creditors of the pledgor (save for cases envisaged by law). In order to obtain satisfaction, the pledgee would need to enforce the pledge (see section 2 below). The pledgee is a secured creditor in insolvency, enjoying a certain priority in the satisfaction of its secured claims (as described further in section 7).

Debtors under secured obligations or third parties can provide a pledge. It is not necessary for the pledged assets to be transferred to the pledgee in order for the pledge to be effective.

Although Russian law does not include the concept of a floating charge, it provides for a somewhat similar form of security called a pledge of goods in circulation.[2] The pledgor is entitled to change the composition and natural form of the pledged goods (e.g. to sell and acquire new goods and to process them), provided that the overall value of such goods does not fall below the agreed value. This type of pledge is used with respect to generic goods, such as raw materials, trade stock, etc.

Generally, a pledge needs to be either registered or recorded to be effective against the pledgor and / or third parties. Registration formalities vary depending on the type of asset.[3]

For example, a pledge of movable property and receivables needs to be recorded in the Register of Notices of Pledges of Movable Property (Pledge Register). Otherwise, it will not be effective against third parties (save for cases in which a third party is otherwise aware or should otherwise have been aware of the pledge).[4,5]

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1 The Supreme Court of Russia (the SC) and the Supreme Commercial Court of Russia (the SCC) (which merged with the SC in 2014) have issued various interpretations and clarifications on the treatment of the secured interests. The lower courts generally follow the legal precedents set by the SC and the SCC.

2 Article 357 of the Civil Code.

3 Article 339.1 of the Civil Code.

4 A pledge which is recorded in the Pledge Register has a priority over a pledge of the same assets which is not recorded or is recorded later. In addition, the pledge so recorded survives in the event of the sale of the pledged property by the pledgor (Articles 339.1(4), 342.1(10), 352(1)(2) and 353(1) of the Civil Code).

5 Pledgors which are Russian companies are also required to file information on all the pledges over their movable property with the Unified Federal Register of Data on Certain Facts of Activity of Legal Entities (Article 7.1(7)(n1) of Federal Law "On the State Registration of Legal Entities and Individual Entrepreneurs" No 129-FZ, dated 8 August 2001 (Law on the State Registration of Legal Entities)). The legal effect of such filing on pledges is not clearly specified in the law.

To become effective, pledges of non-documentary securities (e.g. shares in relation to joint stock companies) need to be registered in the relevant register of securities holders maintained by the registrar or, if they are held by a depositary, with the depositary; whereas pledges of participation interests (in relation to limited liability companies) must be registered in the Unified State Register of Legal Entities to become effective.[6]

Pledges of intellectual property rights (e.g. exclusive rights to trademarks, inventions, utility models or industrial designs) need to be registered with specialised registers for the relevant intellectual property rights to become effective.[7]

A pledge of rights under a bank account (being a special pledge account) does not need to be registered. It becomes effective once a bank is notified of the pledge and is provided with a copy of the pledge agreement. If the bank is also the pledgee, the pledge becomes effective upon the parties' entry into the pledge agreement.[8]

The law does not expressly require that pledge agreements be notarised to be valid except those relating to participation interests. However, notarisation should be considered if a pledge agreement provides for out-of-court enforcement (see further section 2).

1.2 Mortgage

Security over immovable property (such as land, buildings, etc.) is created by way of a mortgage. The benefit of having a mortgage is the same as described above with respect to pledges.[9]

Mortgages become effective upon registration in the Unified State Register of Immovable Property.[10] Generally, mortgage agreements do not need to be notarised. However, if a mortgage agreement contains an out-of-court enforcement procedure, it should be notarised to enable out-of-court enforcement.

Mortgages of assets that the Civil Code treats as immovable by operation of law (such as vessels and aircraft) are to be registered with specialised registers.

1.3 Creating security

Pledges can arise by virtue of contract or law. Some examples of pledges arising by operation of law are as follows:[11]

- assets sold on credit are deemed to be pledged in favour of the seller until they are fully paid (unless the parties to the contract of sale have agreed otherwise);
- a building constructed or purchased with borrowed funds is deemed to be mortgaged in favour of the lender (unless a loan agreement provides otherwise);

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6 Article 51.6(2) of Federal Law "On the Securities Market" No 39-FZ, dated 22 April 1996; Article 22(2, 3) of Federal Law "On Limited Liability Companies" No 14-FZ, dated 8 February 1998.

7 Article 1232 of the Civil Code.

8 Articles 339.1(3) and 358.11 of the Civil Code.

9 Generally, Russian law uses the term "pledge" to describe security over movable and / or immovable property, but a pledge of immovable property is specifically referred to by law as a "mortgage".

10 Article 11(2) of Federal Law "On Mortgage (Pledge of Immovable Property)" No 102-FZ, dated 16 July 1998 (Mortgage Law).

11 Article 488(5) of the Civil Code, Article 73(2.1) of the Tax Code and Article 69.1 of the Mortgage Law.

- assets arrested by a tax authority to secure the payment of taxes are deemed to be pledged in favour of the tax authority (subject to conditions specified in the Tax Code).

As a rule, statutory pledges are subject to the same rules as contractual pledges, including those relating to registration.

1.4 Lien

A lien is a possessory form of security. In some cases a creditor can retain a debtor's property to secure its claims against the debtor (for example, for as long as a customer does not pay a contractor for work done, the contractor can retain the works and other items of the customer in its possession).[12]

Recent court practice suggests that, in the event of the debtor's insolvency, the holder of the lien must transfer the retained assets to the debtor's bankruptcy estate, provided that (i) the relevant record (of the lien-holder's security interest) is made in the Pledge Register and (ii) the holder of the lien is considered a secured creditor with rights analogous to those of the pledgee.[13]

1.5 Retention of title

Some transactions that technically do not involve the creation of a security right nevertheless result in a similar outcome for one of the parties. Legal doctrine refers to these transactions as title-based security arrangements. The main example is where a contract for the sale of assets contains a clause by which the seller retains ownership of the assets until they are fully paid or other circumstances occur as agreed.[14] Other types of the title-based security arrangements are security assignments, financial leasing and repo transactions. Russian law generally recognises the validity of these arrangements but remains undeveloped in this area, and the Supreme Court is yet to develop consistent case law in relation to how to treat such transactions in the event of the insolvency of the debtor, the title holder, or the security provider.[15]

2. How are security rights enforced? Is a court process or out-of-court procedure required or are both methods available? What are the practical difficulties experienced when security is enforced?

2.1 Enforcement of pledges and mortgages

Generally, a pledgee can enforce a pledge through a court or, if so agreed (e.g. in a pledge agreement),

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[12] Lien can be recorded with the Unified Federal Register of Data on Certain Facts of Activity of Legal Entities. In that case third parties will be deemed to be notified of the lien (Article 7.1(12)(v) of the Law on the State Registration of Legal Entities and Article 4(5) of Federal Law "On Amendments to Certain Legislative Acts of the Russian Federation" No 377-FZ, dated 12 November 2019).

[13] SC Ruling No 301-ES19-2351, dated 27 June 2019. We note that this position is not free from legal concerns. In particular, Federal Law "On Insolvency (Bankruptcy)" No. 127-FZ, dated 26 October 2002 as amended (Insolvency Law) does not expressly provide for a secured creditor status for a creditor who retains the debtor's property.

[14] Retention of title can be recorded with the Unified Federal Register of Data on Certain Facts of Activity of Legal Entities. In that case third parties will be deemed to be notified of the retention (Article 7.1(12)(g) of the Law on the State Registration of Legal Entities and Article 4(5) of Federal Law "On Amendments to Certain Legislative Acts of the Russian Federation" No 377-FZ, dated 12 November 2019).

[15] The SCC only set out certain relevant rules as far as the insolvency of the lessor in a financial leasing contract is concerned. The SCC held that the title to the leased object may still pass from the lessor to the lessee in the above circumstances if the lessor is undergoing bankruptcy. Therefore, if the lessee has made all the contractual payments, the lessee's claims are not to be included in the creditors' register and the lessee may withdraw the leased object from the bankruptcy estate. When a financial leasing contract concluded with a lessor that later becomes bankrupt is terminated and the balance of reciprocal obligations is in favour of the lessee, the latter may retain the leased object according to the rules of lien, and it acquires the status of a secured creditor. Clause 2 of the SCC Plenum Resolution No 17, dated 14 March 2014, "On Certain Issues Relating to a Buyout Financial Leasing Contract". See also White & Case review, "Regulating buyout financial leasing based on the credit model" https://www.jdsupra.com/legalnews/regulating-buyout-financial-leasing-base-47449.

an out-of-court procedure. A "mixed" option is also possible, if so agreed (i.e. the pledged assets are to be realised in a manner agreed by the parties but based on a court decision).

In certain cases provided by the law, a creditor can only enforce a pledge through a court-based enforcement process, e.g. if the pledged assets are of high cultural importance, or if an individual's sole residential property is mortgaged (unless, in the latter case, the parties agree on an out-of-court enforcement post-default). A pledgee can also apply to court despite the parties having agreed upon an out-of-court enforcement process. However, in this case the pledgee would bear the costs relating to the court-based enforcement process, unless the pledgee were to prove that the out-of-court procedure did not succeed due to the conduct of the pledgor or a third party.[16]

In the case of an out-of-court procedure, pledged assets can be (i) sold at an auction, (ii) directly sold to a third party, or (iii) acquired by the pledgee. Options (ii) and (iii) are possible only if the pledgor is involved in commercial activities and the pledged assets are to be sold or acquired at no less than its market value.[17]

Where there is out-of-court enforcement of a non-possessory pledge, the creditor would need to apply to a notary for a notary's endorsement if the pledgor does not co-operate, e.g. to obtain possession of the pledged assets for their further realisation. A creditor would also need to apply for the notary's endorsement for the out-of-court enforcement of a mortgage. The notary can issue the endorsement only if the pledge or mortgage agreement was notarised.[18]

The notary's executive endorsement entitles the pledgee:[19]

- to seek the assistance of court bailiffs, who may take possession of the pledged assets from the pledgor (or attach it in case of immovable property) and transfer it to the pledgee for its further realisation or, if so instructed by the pledgee, arrange for its public sale); and

- to apply for registration of the transfer of the title to the mortgaged assets upon foreclosure.

In the case of enforcement by way of a court procedure, the pledged property is to be realised through a public sale unless the pledgee chooses the so-called mixed option mentioned above. Notably, the pledgor can ask a court to defer the public sale for up to one year, which the court can grant if there is a good reason to do so.[20]

Overall, any of the above enforcement procedures can be subject to delays if the third-party pledgor or debtor impedes the enforcement. Furthermore, depending on the type of the pledged assets, the acquirer of the pledged assets may need to obtain regulatory approvals in the course of enforcement.[21]

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16 Article 349(1) of the Civil Code.

17 Where rights under a bank account agreement are pledged, the pledgee can enforce the pledge by way of instructing the bank to debit the funds at the pledge account, either based on the terms of the pledge agreement or a court decision (Article 358.14 of the Civil Code).

18 Article 350.1(4) of the Civil Code, Article 55(1, 4) of the Mortgage Law, Article 94.1 of the Fundamentals of the Legislation of the Russian Federation on the Notariate No 4462-1, dated 11 February 1993.

19 Article 78 of Federal Law "On Enforcement Proceedings" No 229-FZ, dated 2 October 2007, Article 50 of Federal Law "On the State Registration of Immovable Property" No 218-FZ, dated 13 July 2015.

20 Article 350(2) of the Civil Code. The application of that rule in respect of mortgages is limited (the deferral is possible if the property is mortgaged by an individual) (Article 54(3) of the Mortgage Law).

21 For example, the approval of the antimonopoly authority, or the approval of the governmental commission in relation to "strategic" investments.

3. Are pre-insolvency proceedings available? If so, describe the types of pre-insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***
- ***Is shareholder consent required in order to effectuate a restructuring?***

Pre-insolvency proceedings are generally not available in Russia.[22]

An exception is the special regulation on the insolvency of financial institutions (for example, credit institutions and insurance companies).[23] The Central Bank may approve pre-insolvency proceedings aimed at restoring the solvency of financial institutions.[24]

The Central Bank[25] may introduce pre-insolvency proceedings if a financial institution repeatedly, during one month, fails to make a payment within 10 days of it being due, or fails to make a mandatory payment (such as taxes) within 10 days of it being due, or does not have enough funds to make a payment when due.[26]

The Central Bank may appoint a temporary administration of a financial institution for up to six months, with the possibility of a six-month extension provided that the total term does not exceed 18 months.[27] The temporary administration consists of an insolvency administrator and other members selected by the Central Bank.[28]

If a credit institution or an insurance company faces financial difficulties,[29] the Central Bank may decide to use financial rehabilitation measures, including the appointment of temporary administration headed by a

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22 The special legislation designed to mitigate the impact of the COVID-19 crisis for businesses and individuals provides an exception. In particular, the amendments to the Insolvency Law introduced by Federal Law No 166-FZ, dated 8 June 2020 provide for debt-restructuring for protected debtors covered by the insolvency filing moratorium. See White & Case reviews "COVID-19: insolvency filing moratorium in Russia" https://www.jdsupra.com/legalnews/covid-19-insolvency-filing-moratorium-39506, and "COVID-19: Waiver of the Benefit of the Insolvency Filing Moratorium in Russia" https://www.jdsupra.com/legalnews/covid-19-waiver-of-the-benefit-of-the-54493/.

23 See P Boulatov, *Russia: The Insolvency Review* (7th edn, Law Business Research 2019) 296–300. See https://thelawreviews.co.uk/edition/the-insolvency-review-edition-7/1211479/russia.

24 Articles 180(4) and 183.1 of the Insolvency Law.

25 Articles 180(4) and 183.1 of the Insolvency Law.

26 Article 183.2(1) of the Insolvency Law.

27 Article 183.12 of the Insolvency Law.

28 Article 183.6(6) of the Insolvency Law.

29 Grounds to use financial rehabilitation measures with respect of a credit institution or an insurance company are set by Articles 189.10 and 184.1 of the Insolvency Law and include, *inter alia*, failure to meet criteria of liquidity or sufficiency of its assets and failure to make a payment when due.

representative of the Central Bank.[30] If the Central Bank appoints temporary administration, it may limit or suspend the powers of the credit institution's or the insurance company's management. The temporary administration performs an analysis of the debtor's financial situation to make a decision on rehabilitation measures to be introduced; controls the assets of the financial institution; and gives consent to some transactions by the management of the debtor.[31] There are limitations on performing certain transactions, for example, transactions related to the disposal of property, the book value of which is more than 1% of the book value of the assets of the financial institution. The temporary administration may ask the Central Bank to introduce a moratorium on payments by the credit institution or the insurance company.[32]

If the Central Bank decides to suspend the powers of the debtor's management, the temporary administration assumes its functions.[33] State registration of transactions, transfers, restrictions to / encumbrances over the right to immovable property that a financial institution owns, or exercises other property rights in relation to, are suspended.

The temporary administration may file applications with the court to challenge transactions by the financial institution or to hold the financial institution's controlling persons liable.

Special resolution mechanisms apply to major bank and insurance companies.

The Central Bank established the Fund for Consolidation of the Bank Sector and the Fund for Consolidation of the Insurance Sector. The Central Bank is the 100% shareholder of the management company of these funds (Management Company). The Management Company may decide to finance the resolution of major banks or insurance companies and become the controlling shareholder of the distressed bank or insurance company. If the bank or insurance company has negative net assets, the bank's or insurance company's shareholders must transfer their shares to the Management Company for RUB1. The Management Company finances resolution procedures by way of contributions to the bank's or insurance company's charter capital (from the loans it receives from the Central Bank) and acts as the bank's or insurance company's crisis manager. After resolution measures are complete, the Management Company must sell its shares in the bank or insurance company on the market.[34]

4. Are insolvency proceedings available? If so, describe the types of insolvency proceedings that are available, including:

- ***Who can initiate the proceeding?***
- ***What are the criteria used for opening the proceeding?***
- ***Who are the main actors: court, administrator, liquidator, trustee, receiver, controller, representative of creditors, state representatives etc.?***
- ***Does the debtor's management remain in control of the business during the proceeding?***
- ***May contracts and secured and unsecured debts be adjusted in the proceeding without affected creditor consent?***
- ***What is the level of creditor consent that is required to effectuate a restructuring?***

30 Insolvency Law, Articles 189.9 and 184.1.
31 Article 183.10 of the Insolvency Law.
32 Articles 184.3-2, 189.38 of the Insolvency Law.
33 Article 183.11 of the Insolvency Law.
34 Articles 184.3-1, 184.3-3, 184.3-4, 189.49 and 189.50 of the Insolvency Law.

- ***Is shareholder consent required in order to effectuate a restructuring?***

A debtor may file for insolvency if it anticipates that it will not be able to discharge its debts as they fall due.[35] In certain instances (e.g. where the debtor's funds or assets are insufficient to discharge all of its debts), the debtor must file for insolvency.[36] The debtor is required to publish a notice of its intention to file an insolvency petition 15 days in advance.[37]

Creditors, current or former employees (if salary or severance payments to them are in arrears) also have a right to file for insolvency. They must publish a notice of their intention to file an insolvency petition 15 days in advance.[38] Creditors also need to have their claims confirmed by an enforceable Russian court judgment or an arbitral award recognised and enforced in Russia by the Russian court, save for creditors whose claims arise out of banking operations (such as providing credit) and State Corporation VEB.RF.[39] The tax authorities may also file for the insolvency of a debtor without prior confirmation of the tax claims by court judgment.[40]

Generally, the court may initiate insolvency proceedings if the debtor's liabilities are at least RUB300,000 (about USD4,100) and have been overdue for three months.[41]

There is a separate insolvency test for financial institutions.[42] A financial institution may be declared insolvent if: (i) it has failed to perform claims confirmed by a court judgment for more than 14 days, irrespective of the amount of the claim; or (ii) its assets are not sufficient to fulfil its financial obligations; or (iii) it did not become solvent as a result of pre-insolvency proceedings.

A credit institution or a creditor may file an application to declare the credit institution insolvent only after the Central Bank decides to revoke that institution's banking licence. In any event, if the credit institution meets the insolvency criteria at the date of revocation of the banking licence, the Central Bank must file for insolvency within five days of the publication of the revocation of the banking licence, or within five business days of the temporary administration informing the Central Bank about it.[43]

An increased insolvency test also applies to individuals, agricultural enterprises, strategic enterprises and natural monopolies: an individual[44] or agricultural enterprise[45] may be declared insolvent if the amount of outstanding claims exceeds RUB500,000 (about USD6,800); and a strategic enterprise[46] or a natural monopoly[47] may be declared insolvent if the amount of creditors' claims exceeds RUB1 million (about USD13,700), and the claims have been overdue for more than six months.

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35 Article 8 of the Insolvency Law.
36 Article 9 of the Insolvency Law.
37 Article 7(2.1) of the Insolvency Law.
38 Ibid.
39 Article 7(2) of the Insolvency Law. The SC interpreted this rule as giving a right to any person whose claims arise out of banking operations (as defined in Article 5 of Federal Law No 395-1, dated 2 December 1990, on Banks and Banking Activities) to file for insolvency of its debtors using the simplified procedure. This may apply to persons who acquired claims from the banks (SC Ruling No 306-ES16-3611, dated 12 October 2016). The banks, however, cannot use the simplified procedure if their claims do not arise out of banking operations (for example, claims related to lease or construction agreements) (SC Ruling No 305-ES16-18717, dated 27 March 2017).
40 Article 7(2) of the Insolvency Law.
41 Articles 3(2) and 6(2) of the Insolvency Law.
42 Article 183.16 of the Insolvency Law.
43 Article 189.61 of the Insolvency Law.
44 Article 213.3(2) of the Insolvency Law.
45 Article 177 of the Insolvency Law.
46 Article 190 of the Insolvency Law.
47 Article 197 of the Insolvency Law.

More flexible rules apply to mortgage agents.[48] The charter of a mortgage agent may provide that the obligation to file an insolvency petition arises when a certain period lapses and / or a certain event occurs. This charter provision prevails over general insolvency law requirements, i.e. the mortgage agent does not have to file for its insolvency on general insolvency law grounds unless the circumstances set out in its charter take place. Similarly, a creditor of a mortgage agent may not file for insolvency of this mortgage agent on general insolvency law grounds where an agreement (a non-petition clause) between such creditor and the mortgage agent provides that this creditor's right arises when a certain period lapses and / or a certain event occurs and where such circumstances have not arisen.

4.1 Insolvency procedures

4.1.1 Supervision

As a general rule, supervision is the first, and mandatory, stage of insolvency proceedings.[49] It applies to a debtor with a view to preserving its property, analysing its financial position, preparing a register of creditors' claims and holding the first meeting of creditors. It should be completed within seven months of the submission of the insolvency petition.[50]

Once supervision has commenced, creditors' claims for payment other than post-commencement claims may only be filed against the debtor pursuant to the procedures outlined in the Insolvency Law. Enforcement proceedings that have already commenced are stayed (with some exceptions). Court proceedings for recovering funds from the debtor are stayed upon a creditor's petition. In addition, upon commencement of supervision, no contractual interest and penalties shall accrue on any claims that can be registered irrespective of whether they are already registered or not. Rather, "moratorium interest" shall accrue on the principal debt at the Russian Central Bank's key rate[51] applicable at the date supervision is introduced.[52]

When the court orders the commencement of the supervision procedure, it will appoint an insolvency administrator. The insolvency administrator must convene the first creditors' meeting no later than 10 days before the end of the supervision. Only those creditors that have presented their claims within 30 days of the date of making the publication on the commencement of supervision, and were registered in the debtor's register of claims, have the right to take part in the first meeting of creditors.[53] Although missing the aforementioned 30-day deadline will preclude a creditor from participating in the first creditors' meeting, it will not preclude creditors from submitting their claims to the register of creditors' claims at a later stage.

The creditors at the first creditors' meeting are authorised to decide which procedure (financial rehabilitation, external management, or receivership) should be implemented. However, the court takes the final decision on this matter.[54]

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48 Article 230.1 of the Insolvency Law.

49 In some cases, supervision does not apply, and the court commences receivership if it finds that the insolvency application has merit. For example, this happens if the debtor commences voluntary liquidation before the insolvency proceedings or if the debtor is missing at its place of location and no longer operates.

50 Article 51 of the Insolvency Law. The durations of insolvency procedures mentioned herein are for indicative purposes only, and the court may exceed the time limits if necessary and appropriate.

51 The key rate is published at www.cbr.ru. As of 27 July 2020, the rate is 4.25% per annum.

52 See White & Case review "Accrual and payment of interest on creditors' claims in insolvency" https://www.jdsupra.com/legalnews/accrual-and-payment-of-interest-on-credi-10103.

53 Article 72(1) and 72(2) of the Insolvency Law.

54 Article 73 of the Insolvency Law.

4.1.2 *Financial rehabilitation*

Financial rehabilitation is an insolvency procedure that is applied to a debtor for the purpose of restoring its solvency and for discharging its debts in accordance with an approved debt repayment schedule.[55] Financial rehabilitation lasts for no more than two years.[56]

Financial rehabilitation may only commence once a petition of the debtor's shareholders or any third party interested in the restoration of the debtor's solvency is submitted.[57] According to Judicial Department statistics, financial rehabilitation is introduced very rarely (18 cases in 2018,[58] 21 cases in 2019[59]).

Based on the results of financial rehabilitation, the court will decide either to terminate insolvency proceedings (if the debts have been discharged) or commence external management (if the debtor may still become solvent) or receivership.[60]

4.1.3 *External management*

External management is an insolvency procedure applied to a debtor for the purpose of restoring its solvency. As a rule, the court introduces external management on the basis of a decision taken at the creditors' meeting. External management is usually limited to an initial period of up to 18 months and can be extended by a further six months.[61] The aggregate term of external management together with financial rehabilitation cannot exceed two years.[62]

According to Judicial Department statistics, external management is introduced in rare cases (254 cases in 2018,[63] 186 cases in 2019[64]).

Based on the results of external management, the court either terminates insolvency proceedings (if the debts have been discharged), orders settlement with the creditors according to the register of claims (if the debtor's solvency has been restored) or commences receivership.[65]

4.1.4 *Receivership*

The court introduces receivership by way of a judgment declaring the debtor insolvent. The aim of receivership is to satisfy creditors' claims according to the priorities established by law. Receivership lasts for up to six months and may be extended for a further six months.[66]

Pursuant to the Insolvency Law, all of the debtor's assets must be included in the bankruptcy estate.

According to Judicial Department statistics, receivership applies in the vast majority of cases (it was introduced in 13,254 cases in 2018[67] and in 12,378 cases in 2019).[68]

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55 Article 80(3) of the Insolvency Law.
56 Article 80(6) of the Insolvency Law.
57 Article 76 of the Insolvency Law.
58 http://www.cdep.ru/index.php?id=79&item=4890.
59 http://www.cdep.ru/index.php?id=79&item=5257.
60 Article 88(6) of the Insolvency Law.
61 Article 93 of the Insolvency Law.
62 Article 92(2) of the Insolvency Law.
63 http://www.cdep.ru/index.php?id=79&item=4890.
64 http://www.cdep.ru/index.php?id=79&item=5257.
65 Article 119(6) and 119(7) of the Insolvency Law.
66 Article 124(2) of the Insolvency Law.
67 http://www.cdep.ru/index.php?id=79&item=5257.
68 http://www.cdep.ru/index.php?id=79&item=4890.

Based on the results of the receivership, the commercial court orders either the termination of insolvency proceedings (if the debts have been discharged by the debtor's shareholders) or the completion of receivership. The receivership is deemed completed when the liquidation of the debtor is registered with the Unified State Register of Legal Entities.[69] During the course of any of the aforementioned procedures, a debtor and its creditors may terminate the insolvency proceeding at any stage thereof by amicable settlement.

4.1.5 Insolvency of individuals

With respect to individuals, the following insolvency procedures may apply: restructuring of debts and a sale of assets.[70] [71]

If the court finds that the insolvency petition has merit, it introduces, as a general rule, the procedure of debt restructuring and appoints an insolvency administrator.[72] In the course of this procedure, the insolvency administrator analyses the financial situation, a moratorium on the payment of debts is introduced, and no interest or penalties accrue on any claims (except for post-commencement claims). The debtor cannot enter into any transactions for a value exceeding RUB50,000 (about USD700) without the consent of the insolvency administrator.[73] The debtor or the creditors may work out a debt-restructuring plan providing for repayment of debts for no more than three years.[74] The court approves this plan if it meets the criteria set by the Insolvency Law, it is realistic and does not breach third parties' rights. In certain cases, the court may approve the debt-restructuring plan without the consent of the debtor or the creditors.[75]

If there is no basis for the approval of a debt-restructuring plan, the court declares the debtor insolvent and commences the procedure for the sale of assets.[76] The aim of this procedure is to have the debtor's assets sold and the creditors' claims repaid.

Certain assets of an individual do not constitute a part of the bankruptcy estate.[77] Such assets include the sole residential property of the individual and land plots on which the premises are situated (provided that the land plots are not mortgaged) and the equipment necessary for the debtor to conduct his or her professional activities worth not more than RUB1,213,000 (about USD16,600).[78]

4.1.6 Insolvency of financial institutions

As a general rule, only the supervision procedure and receivership are applied to financial institutions. However, the supervision procedure is not applicable to certain financial institutions, for example, to insurance companies or once the temporary administration of a financial institution has been appointed.[79] If the court finds that an insolvency petition filed by a creditor of an insurance company has merit, the insolvency proceedings will be suspended until the Central Bank or the temporary administration files for insolvency of the insurance company.[80]

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69 Article 149 of the Insolvency Law.
70 Article 213.2 of the Insolvency Law.
71 As of 1 September 2020 amendments to the Insolvency Law entered into force which provide that individuals may undergo a different, simplified out-of-court insolvency procedure, governed by special rules (Federal Law No 289-FZ dated 31 July 2020).
72 Article 213.6 of the Insolvency Law.
73 Article 213.11 of the Insolvency Law.
74 Article 213.14(2) of the Insolvency Law.
75 Article 213.17(4) of the Insolvency Law.
76 Article 213.24 of the Insolvency Law.
77 Article 213.25(3) of the Insolvency Law; Article 446 of the Civil Procedure Code.
78 100 minimum salaries. A minimum salary set by the Russian government is RUB12,130 (about USD166) as of 1 January 2020.
79 Article 183.17 of the Insolvency Law.
80 Article 184.4(3) of the Insolvency Law (as amended by Federal Law No 222-FZ, dated 23 June 2016, effective as of 21 December 2016).

4.2 Role of an insolvency administrator

Under the Insolvency Law, insolvency proceedings are controlled and managed by an insolvency administrator, who is supervised by the court.

The insolvency administrator's powers vary depending on the stage of the insolvency proceedings. In general, its functions include the following:[81]

- to control the debtor's business, assets, accounting and other documents and related information;
- to request information regarding the debtor's activities and operations from third parties;
- to contest or agree with creditors' applications for the registration of claims;
- to hold the register of creditors' claims and distribute the proceeds of the sale of the debtor's assets;[82]
- to arrange for the sale of assets – for this purpose, the insolvency administrator is empowered to make an inventory of assets, prepare draft conditions of sale and select the valuer and auction organiser;
- to challenge the debtor's transactions;
- to prepare and file applications to hold the debtor's controlling persons liable for their actions; and
- to call and arrange creditors' meetings.

During external management and receivership, the insolvency administrator replaces the debtor's management. Given these wide powers, the qualifications and integrity of the insolvency administrator are important for the proper conduct of the insolvency proceedings.

4.3 The creditors' meeting

The creditors' meeting is the primary body through which the creditors exercise control over the insolvency proceedings. At such meetings the creditors may decide upon the strategy of the proceedings (e.g. to choose the insolvency procedures to be applied for), or to enter into a settlement agreement.[83] It is through this body that the creditors control the insolvency administrator. For instance, the terms of sale of the debtor's non-encumbered assets by the administrator must be approved by the creditors' meeting.[84] At the meetings, the creditors are also empowered to nominate the administrator or request that the court removes the current administrator (provided that he or she has breached the law).[85]

The voting rights of secured creditors to control the proceedings are limited. They can vote at the supervision stage. During financial rehabilitation or external management, they can only vote if they decide not to enforce the collateral in the course of the respective insolvency procedures.[86] However, generally, secured creditors have very limited voting rights during receivership unless they prefer to waive their secured rights and register their claims as non-secured.[87] Nonetheless, the secured creditors have

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81 Articles 12(7), 20.3, 66, 67, 71(2), 83, 99 and 129 of the Insolvency Law.
82 The insolvency administrator generally includes claims to the register upon a court decision. The exceptions include employees' claims.
83 Article 12 of the Insolvency Law.
84 Article 139(1.1) of the Insolvency Law.
85 Article 12(2) of the Insolvency Law.
86 Article 18.1(3) of the Insolvency Law.
87 Article 12(1) of the Insolvency Law.

the right of veto with respect to certain matters (e.g. the settlement agreement,[88] substitution of the debtor's assets).[89] Further, secured creditors have voting rights on the nomination of insolvency administrators and their removal.[90]

4.4 The creditors' committee

The role of the creditors' committee is to streamline control of the creditors over the actions of the insolvency administrator. The creditors' meeting may also delegate certain powers to the creditors' committee,[91] such as to request information on the debtor's financial situation and the status of the receivership from the insolvency administrator; to challenge the administrator's actions in court; and to approve conditions for a sale of assets.[92]

4.5 Other persons participating in an insolvency

The following persons may participate in an insolvency:[93]

- a representative of the debtor's employees;
- a representative of the owner of assets of a debtor if the debtor is a state-owned (unitary) enterprise;
- a representative of the debtor's founders (shareholders / participants);
- representatives of the creditors' meeting and the creditors' committee respectively;
- the Federal Security Service, if the exercise of authority of the insolvency administrator is connected with access to data constituting state secrets;
- representatives of the constituent entities of the Russian Federation and municipalities at the location of the debtor;
- other persons in the specific cases provided for by the Commercial Procedural Code of the Russian Federation and the Insolvency Law.

In addition, the following persons have a right to participate in an insolvency: a self-regulated organisation of insolvency administrators and creditors with claims arising out of post-commencement claims.

4.6 Representatives of the Russian Federation

Tax authorities file and present claims for mandatory payment and claims of the Russian Federation relating to monetary obligations of a debtor.

The Federal Service for State Registration, Cadastre and Cartography (*Rosreestr*) supervises the activity of the insolvency administrators, as well as their self-regulated organisations.[94]

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88 Article 150(2) of the Insolvency Law.
89 Article 138(4) of the Insolvency Law.
90 Article 12(1) of the Insolvency Law.
91 Article 17(1) of the Insolvency Law.
92 Article 17(3) of the Insolvency Law.
93 Article 35 of the Insolvency Law.
94 Article 2 of the Insolvency Law.

4.7 Court

Under Russian law, all insolvency cases in Russia may be considered only by commercial (*arbitrazh*) courts – neither civil courts nor arbitration tribunals may administer insolvency proceedings.

The court's discretion and powers to control the insolvency proceedings are wide. The court takes the final decision on which insolvency procedures should be implemented, on the matter of the removal of the insolvency administrator, the registration of creditors' claims, declaring transactions of the debtor invalid and resolving any differences between the insolvency administrator and the creditors (such as in relation to the terms of sale of assets). Any decisions taken by the insolvency administrator, the creditors' meetings[95] and creditors' committee may be challenged in court by the parties to the insolvency proceedings.

During supervision the debtor's management remains in office and continues to perform its functions (although the insolvency administrator is authorised to petition for the replacement of the debtor's current management in court).[96] Once supervision has commenced, the debtor's management is prohibited from engaging in certain types of transactions and from making certain decisions.[97] Decisions on other matters, such as the alienation of assets valued at more than 5% of the balance sheet, granting or receiving loans, issuing guarantees and sureties and assignments of rights, require the prior written approval of the insolvency administrator.[98]

As with supervision, during financial rehabilitation, management retains control of the debtor, but its powers are restricted. The court must appoint an insolvency administrator who is authorised to supervise the implementation of the debt repayment schedule and the financial rehabilitation plan.[99] The consequences of commencing financial rehabilitation are generally similar to those of supervision, where certain actions by the debtor are prohibited, and where other actions require the approval of the administrative manager or of the creditors' meeting.[100]

Upon commencement of external management, the court must appoint an insolvency administrator. The insolvency administrator takes over the management of the debtor's business, may dispose of the debtor's property (subject to decisions to be taken at the creditors' meeting in certain cases, e.g. the alienation of assets valued at more than 10% of the balance sheet value of all assets) and may reject certain transactions concluded by the debtor if such transactions impede the restoration of the debtor's solvency or their performance would cause loss to the debtor. The insolvency administrator maintains and recovers funds due to the debtor and develops and implements an external management plan that is approved by a decision taken at the creditors' meeting and contains measures necessary to restore the debtor's solvency.[101]

During receivership, the insolvency administrator replaces the director general of the debtor.[102] The insolvency administrator draws up an inventory of the debtor's assets and takes measures for their protection, appoints an appraiser to value the debtor's estate, arranges for sale of the debtor's assets, recovers funds due to the debtor, searches for and returns any of the debtor's assets that are in the possession of third parties, informs the debtor's employees of their prospective dismissal, and makes distributions to the creditors according to the register of creditors' claims.

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95 Article 15(4) of the Insolvency Law.
96 Article 69 of the Insolvency Law. In this case the shareholders select a new director according to the general procedure.
97 Including, among others, reorganisation and liquidation of the debtor, establishing or acquiring equity interests in other legal entities, the creation of branches and representative offices, making dividend payments and issuing securities.
98 Article 64 of the Insolvency Law.
99 Articles 82 and 83 of the Insolvency Law.
100 Article 81 of the Insolvency Law.
101 Article 99 of the Insolvency Law.
102 Articles 127 and 129 of the Insolvency Law.

The debtor and its creditors may adjust contracts and secured and unsecured debts by entering into an amicable settlement at any stage of the insolvency proceedings. Third parties may also participate and accept certain rights and obligations according to an amicable settlement. Creditors may take a decision on amicable settlement at a creditors' meeting.

This decision is taken by a simple majority of unsecured creditors' votes in existence provided that all the secured creditors vote for the amicable settlement. Therefore, the secured creditors have a right of veto with respect to settlement agreements. A settlement agreement may provide for a discount on claims of a creditor, lower applicable interest rate, or settlement of claims by way of transfer of assets (rather than monetary funds) only if the relevant creditor agrees.[103]

Any amicable settlement must be approved by the court. The court may withhold approval for a number of reasons, including a failure to make full payment of claims of the first and second priority, a breach of third parties' rights or breach of the rights of creditors who voted against the settlement or did not agree to it.[104] An amicable settlement is not binding on any creditors whose claims were not registered as of the date it was concluded and who did not participate in it for this reason.[105]

A settlement agreement restructuring creditors' claims against the debtor does not affect the position of a creditor whose claims are secured by a third party in the latter's insolvency proceedings provided that the creditor voted against the terms of the settlement agreement of the principal debtor.[106]

Where the restructuring terms are set out in the settlement agreement, they must be approved by a majority of registered creditors and all creditors whose claims are secured by pledges (see section 4.5 above).

Where a restructuring takes the form of substituting the debtor's assets (contribution of the assets to a newly created company in return for its shares) during a receivership or external management, it must be approved by the creditors' meeting and by all creditors whose claims are secured by pledges.[107]

A restructuring in the form of a debt-for-equity swap where additional shares are issued in exchange for debt forgiveness may take place either prior to insolvency proceedings or during supervision, financial rehabilitation or external management. In this event, a decision to increase the share capital requires the approval of the debtor's shareholders.[108]

As the Insolvency Law does not provide for any shareholder cram-down, creditors generally cannot acquire equity without shareholders' consent in the insolvency proceedings.

5. Could the granting of a security right or interest to a specific creditor be voided or be deemed a preferential treatment prejudicing the rights of the debtor or third parties? What are the grounds upon which the security right or interest can be challenged?

The granting of a security right or interest to a specific creditor may be challenged as a transaction

[103] Article 156 of the Insolvency Law.
[104] Articles 150–167 of the Insolvency Law.
[105] According to Article 9.1 (3.1–3.5) of the Insolvency Law introduced to mitigate the impact of the COVID-19 crisis, a protected debtor that has filed an insolvency petition during the insolvency filing moratorium may apply for approval of a restructuring plan after the court introduces the first insolvency procedure and the first creditors' meeting takes place. There is no need for approval of the debt-restructuring plan by the creditors. The restructuring plan concerns all creditors' claims, including those that are not registered on the register of creditors' claims, irrespective of the contract provisions that define an event of default.
[106] SC Rulings No 305-ES18-11645(3), dated 28 May 2020; and No 308-ES16-1443, dated 14 June 2016.
[107] Articles 115(2) and 141 of the Insolvency Law.
[108] Articles 64(5) and 114 of the Insolvency Law.

leading to preferential treatment of certain creditors.[109]

The court may declare such a transaction invalid if it is made: (1) after the court has accepted the insolvency petition or within one month before this date; and (2) within six months before this date, provided that the pledgor knew about the debtor's insolvency, or the insufficiency of the debtor's assets, when the transaction was made.[110]

The court may not declare a transaction of a debtor invalid as a transaction leading to preferential treatment of certain creditors upon a relevant application, if this transaction has been made in the course of usual business of the debtor and the value of this transaction is less than 1% of the assets of the debtor.[111]

The granting of a security right or interest to a specific creditor may also be challenged as a transaction aimed at violating creditors' rights and interests, provided that the other party was aware of such intent by the insolvent entity.[112] The court may declare such a transaction invalid if it is made within three years prior to the registration of the insolvency application by the court or after this date.

A security right or interest can also be challenged on general civil law grounds, in particular, based on Articles 10 and 168 of the Civil Code, which prohibit the abuse of rights and the exercise of civil law rights aimed at evading the law for an illegitimate purpose, as well as other intentional exercise of civil law rights in bad faith.

The Insolvency Law provides the insolvency administrator (at the receivership stage) and major creditors of the debtor (those owning 10% or more of the common value of the debt of the insolvent entity) with a right to challenge such transactions of the debtor.[113]

6. Is enforcement of security rights treated differently in each type of proceeding?

The enforcement of a pledge is not allowed during the supervision stage.[114]

During financial rehabilitation or the external management stages, the court may approve the enforcement of the pledge if (1) such enforcement does not prevent the debtor from restoring its solvency, or (2) there is a risk of damage to the pledged assets, which may result in a significant reduction in their value, as well as the risk of their loss.[115]

During receivership, the enforcement of the pledge is available pursuant to the procedure, discussed below.

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[109] Article 61.3 of the Insolvency Law. This category includes, among others, transactions intended to secure previously existing obligations of the debtor or a third party to a particular creditor; and transactions that have resulted, or may result in, a change in the order of priorities for satisfying creditors' claims. Clause 12 of the SCC Plenum Resolution No 63, dated 23 December 2010. Clause 5 of the Information Letter of the SCC Presidium No128, dated 14 April 2009.

[110] With respect to mortgages, the transaction is considered to be made at the date of registration of the mortgage in the state register (SC Ruling No 307-ES15-17721(4), dated 17 October 2016).

[111] Article 61.4(2) of the Insolvency Law.

[112] Article 61.2(2) of the Insolvency Law, paragraph 6 of clause 8 of the SCC Plenum Resolution No 63, dated 23 December 2010.

[113] Article 61.9(1) of the Insolvency Law.

[114] Article 18.1 (1) of the Insolvency Law.

[115] Article 18.1 (2) of the Insolvency Law.

7. What are the relative priorities in distributions among creditors and shareholders of the debtor during a pre-insolvency or insolvency proceeding?

Russian insolvency proceedings generally tend to liquidate the debtor and secure the enforcement of pledges. Unsecured creditors rarely get any significant amounts from the insolvency process. In 2019, the rate of satisfied claims of unsecured creditors was 2.4%, and the rate of satisfied claims of secured creditors was 30.7%.[116]

7.1 General order of priorities

The Insolvency Law sets out the following general order of priority for satisfying the claims in the register of creditors:[117]

- claims of compensation for damage to health or loss of life;
- employees' salaries, severance payments, and royalties;
- all other claims (including taxes and other mandatory payments); claims for penalties, financial sanctions and lost profit are recorded separately in the register and are paid after payment of all other third-priority claims.

The Insolvency Law provides that lower priority claims against a debtor cannot be satisfied earlier than higher priority claims. If the debtor's assets are insufficient to satisfy claims of one priority, the claims of this priority will be paid *pro rata*.

7.2 Secured creditors' claims

As a general rule, secured claims against a debtor are third-priority claims. However, the Insolvency Law stipulates a special order of payment for secured claims. Secured creditors get 70% (80% if the secured claim arose out of a loan agreement with a credit institution) of all proceeds of sale of the pledged assets to compensate for the principal debt and any accrued interest. Secured claims for contractual penalties do not have priority over other creditors' claims with respect to the principal debt, but they have priority over other creditors' claims with respect to penalties.[118] If there are no claims of the first and second order of priority, the secured creditor may get up to 90% of all proceeds of sale of the pledged assets (or 95% for claims out of a loan agreement with a credit institution). If the proceeds of the sale of the collateral are insufficient to pay out the secured claim, the balance of the claim will be paid in the same priority as an unsecured claim.[119]

Similar rules will apply for a bank account pledge: the secured creditor's claims must be satisfied by way of debiting funds from the pledge account on the basis of the receiver's instruction and crediting them to the account specified by the creditor. Secured creditors get 70% (80% if the secured claim arose out of a loan agreement with a credit institution) of the funds available in the pledge account, but not more than the amount secured by the pledge.[120]

The order of priority for distributions applicable in the course of the insolvency of individuals differs from the general order of priority. The major difference is that claims in the first order of priority include

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[116] See Statistics of the Unified Federal Register of Information Regarding Insolvency https://fedresurs.ru/news/b0546f18-6128-4806-8cf3-7aea6f4834b3.

[117] For specific types of enterprises, the ranking may differ.

[118] SC Ruling No 301-ES16-17271, dated 30 March 2017.

[119] This does not apply to collateral provided by third parties.

[120] Article 138 (2.2) of the Insolvency Law.

alimony claims and that a secured creditor receives 80% of the proceeds from the sale of pledged assets. In addition, a secured creditor may additionally receive up to 10% of the sale proceeds, if there are no claims of the first and second orders of priority,[121] and may additionally receive up to 10% of the sale proceeds if they are not used for the payment of court fees or the insolvency administrator's expenses.[122]

As noted above, a pledge over a debtor's assets may arise by virtue of law as a result of attachments imposed by the tax authorities.[123] This pledge has no priority over any pledge of the attached assets existing as of the date of the attachment. It is not clear whether this pledge entitles the tax authorities to have their claims registered as secured claims in the event of insolvency. According to the Supreme Court's earlier position, the pledgee's rights arising out of an attachment imposed by bailiffs provide no priority rights in the event of insolvency.[124] At the time of writing, the Supreme Court has not yet had a chance to consider whether this position applies to the above statutory pledge securing tax claims.

7.3 Subordination of claims

The court may subordinate claims arising from the financing of the debtor by affiliated creditors to claims of registered ordinary creditors.[125] The Supreme Court has explained that inter-group creditor claims may be subordinated to other registered claims in the following situations:

- a debtor's controlling person provides financing to the debtor when it is in financial distress (i.e. shows signs of insolvency) – the financing may take various forms, for example, the granting of a loan, abstaining from debt recovery, or providing favourable payment conditions under the debtor's commercial contracts;
- a creditor affiliated with a debtor's controlling person provides financing to the debtor under the influence of the controlling person;
- a debtor's affiliate or controlling person subrogates in the rights of a third-party creditor during the debtor's financial distress, or upon the condition that the debtor compensates its affiliate for the discharge of its obligation;
- a debtor's controlling person is held liable on the grounds that its action or inaction precludes the full satisfaction of creditors' claims;
- a debtor's controlling person grants a loan to the debtor during the initial period of the debtor's business with the sole purpose of allocating risks in the event of insolvency; for these purposes the court may take into account the fact of the intentional thin capitalisation of the debtor's business;
- a debtor's controlling person grants a loan to the debtor while it is distressed based on an agreement between the controlling person and the debtor's major third-party creditor for the purposes of debt restructuring (except in cases where the debtor's minority creditors are parties to this agreement or their rights and interests are not violated by this agreement).

The Supreme Court has also articulated rules for the protection of credit institutions if they are deemed to be controlling persons as a result of their security arrangements. For example, credit institutions providing financing may become controlling persons by virtue of repo or share pledge transactions that provide for

[121] SC Ruling No 307-ES19-25735, dated 21 May 2020.
[122] Article 213.27 of the Insolvency Law.
[123] Article 73 (2.1) of the Tax Code, introduced by Federal Law No 325-FZ, dated 29 September 2019, in force as of 1 April 2020.
[124] SC Ruling No 301-ES16-16279, dated 27 February 2017.
[125] The Review was approved by the SC Presidium on 29 January 2020 "Review of Court Practice for Resolution of Disputes Related to Establishment of Requirements to a Debtor's Controlling Persons and Affiliates in Insolvency Proceedings".

the transfer of voting rights. In this context, claims of credit institutions may not be subordinated (provided that they do not aim to participate in the distribution of the debtor's profits).[126] This clarification can be potentially extended to other situations where a facility is secured by the transfer of title (title-based financing), e.g. to financial leasing.

7.4 Lowest priorities

The following ordinary claims have the lowest priority:

- claims arising out of the consequences of a transaction aimed at the fraudulent transfer of assets or claims of creditors that are aimed at receiving undue preference (as discussed below);[127]
- claims arising out of perpetual bonds;[128]
- claims of creditors that are obliged to perform their obligations and to transfer assets to the bankruptcy estate only after the latter performs its obligations in favour of the respective creditors.[129]

With a number of exceptions,[130] claims filed after the register of creditors' claims is closed (i.e. two months after the publication of the judgment to declare the debtor insolvent and to open the receivership procedure) would fall to the lowest priority and would only be satisfied after all registered creditors' claims.

Shareholders' claims arising out of participation in the debtor's share capital, including claims for the payment of dividends,[131] may only be satisfied after the bankruptcy estate fully repays creditors' claims.

8. How can secured creditors protect their interests in collateral during a pre-insolvency or insolvency proceeding?

Before the insolvency, it is in the interests of the creditor to ensure that the pledge is properly registered. If the debtor does not properly perform the secured obligation, the creditor can consider taking various measures to ensure the safekeeping of the pledged assets, e.g. apply to court for their attachment. In the case of a pledge of receivables, the creditor can send a notice to the pledgor's counterparty so that payments are made directly to the creditor. Also, if the agreement on the pledge of receivables provides that payments from the pledgor's counterparty are to be made to the pledgor's pledge account, the creditor can then enjoy secured creditor status in respect of those funds.[132]

Creditors can also consider enforcing the pledge if the debtor does not properly perform the secured

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126 Clause 11 of the Review approved by the SC Presidium on 29 January 2020 "Review of Court Practice for Resolution of Disputes Related to Establishment of Requirements to a Debtor's Controlling Persons and Affiliates in Insolvency Proceedings".

127 Articles 61.6(2) and 134(4) of the Insolvency Law.

128 Article 134(4) of the Insolvency Law.

129 SC Ruling No 305-ES18-11840, dated 26 November 2018.

130 Despite the strict rule that claims filed late will fall in the lowest order of priority, case law has developed a number of *ad hoc* exceptions, such as where application of the strict rule is manifestly unjust or where the claims became due and payable after the time period for filing claims for registration expired. For example, if a bank makes a payment to a beneficiary under a bank guarantee after the register of creditors of the principal had been closed, the bank may file its redress claims for registration in the register of creditors of the principal within two months from the date they became due. In this case, these claims would not fall to the lowest priority (SC Ruling No 307-ES14-100, dated 24 September 2014). Tax inspectorates also have an additional six months after the date the register is closed to file their claims if the decision to collect taxes enters into force after the date the register is closed. The time period for filing claims for compensation of damage that a controlling person caused a legal entity starts running from the date when the limitation period to hold the controlling person liable started running (i.e. from the date the claimant became aware of the grounds to hold the controlling person liable).

131 SC Ruling No 305-ES20-16, dated 11 June 2020.

132 SC Ruling No 305-ES18-8062(2), dated 22 November 2018.

obligation. The creditors should bear in mind the term of the pledge agreement, as well as the relevant limitation period for enforcing the pledge.[133]

If the enforcement is later challenged in insolvency as a preferential transaction, it can be set aside only to the extent of the preference provided (i.e. with due regard to the priority rules provided by law: see section 7 above).[134]

If the enforcement is made through the court, the relevant court decision would be a basis for lodging a creditor's secured claims in the register of creditors' claims which the competing creditors and the insolvency administrator may only contest by filing an appeal against the decision outside of the insolvency proceedings.[135]

Once the insolvency proceedings have been initiated, creditors should submit their claims to the register of creditors' claims in a timely manner so as to ensure that they can obtain secured creditor status. If the creditor does not file its secured claims in the pledgor's insolvency proceedings at all, the pledged assets will be sold without the creditor's consent and the pledge will terminate.[136] Also, in the case of a third-party pledge, if the debtor becomes insolvent, the creditor should submit its claims to the pledgor before the debtor is liquidated, otherwise the pledge will terminate once the debtor is liquidated.[137]

It would be in the interests of the secured creditor to submit its claims for recording in the register of creditors' claims as soon as possible, to be able to take part in the first creditors' meeting (which will decide, *inter alia*, on the choice of the insolvency administrator).

In theory, creditors can enforce the pledge during financial rehabilitation or external management (subject to authorisation of the court and limitations mentioned in section 6). However, given these procedures are quite rare in practice, the pledged assets will be most likely sold at an auction in the course of the receivership.

During receivership, the secured creditors are vested with the power to determine the initial sale price for selling the pledged assets at the auction, the procedure and the terms of the auction, as well as the procedure and terms for ensuring the safekeeping of the pledged assets. However, if other creditors or the insolvency administrator disagree with the secured creditor's proposed terms, they can ask the court to amend them.[138]

If the pledged assets may be sold together with unsecured assets of the debtor (e.g. as a single

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133 In particular, in case of a third-party pledge, if the term of the pledge is not specified in the pledge agreement, the pledge will terminate if the pledgee does not submit its claim to the pledgor within one year after the secured debt matures, see Resolution of the Constitutional Court of the Russian Federation No 18-P, dated 15 April 2020. This rule is equally applicable in insolvency proceedings. This approach is based on the application of certain rules on suretyship to third-party pledges (Article 335(1) of the Civil Code). See also section 9 below in relation to suretyship.

134 If pledged assets were transferred to the secured creditor in settlement of a claim, the pledgor does not have to return those assets to the bankruptcy estate in full. Instead, the pledgor may transfer funds in the amount required to discharge higher-ranking obligations whilst an application to challenge the transaction is being considered. In this case, the court will refuse to declare the transaction invalid. Clause 29.3 of the SCC Plenum Resolution No 63, dated 23 December 2010. See also White & Case review "Challenging transactions made by debtors in anticipation of insolvency" https://www.jdsupra.com/legalnews/challenging-transactions-made-by-debtors-13620/.

135 Clause 24 of the SCC Plenum Resolution No 35, dated 22 June 2012 "On Certain Procedural Issues Related to Insolvency Proceedings".

136 SC Ruling No 308-ES16-1368, dated 26 May 2016.

137 SC Ruling No 304-ES18-26241, dated 13 June 2019. This approach is based on application of certain rules on suretyship to third-party pledges. See also section 9 below.

138 Article 138(4) of the Insolvency Law.

production complex), such sale is only possible with the consent of the secured creditor (subject to limited exceptions).[139]

A secured creditor is entitled to appropriate the pledged assets if they are not sold at a second auction or in the course of the public offering which follows the latter (subject to statutory rules as to the price at which the assets can be appropriated).[140]

9. Can the rights of a creditor against a non-debtor guarantor be affected in a proceeding of the primary obligor?

If a debtor fails to fulfil its obligation to a creditor, the creditor is entitled to make a claim against the surety (guarantor). Thus, if a debtor defaults on a creditor's claim, a creditor may look to the surety who is responsible for paying the guaranteed amount.[141] If a surety has reimbursed a creditor's claim for the debtor, the surety shall have the right of subrogation, i.e. the right to seek compensation of its payment under the guarantee from the debtor, including in the debtor's insolvency proceedings (if any).

The liquidation of the primary obligor and the subsequent termination of all of its obligations terminates the suretyship unless the creditor has filed a claim against the surety before the primary obligor is liquidated.[142]

The creditor should file a claim against the surety before the secured obligation terminates as a result of the completion of the personal insolvency proceedings of the principal obligor (which would release the insolvent individual from his or her obligations).[143]

Also, if the creditor missed the time limit for filing claims in the insolvency proceedings of the primary obligor, its claims to the surety will fall in the lower order of priority in the insolvency proceedings of the surety.[144]

In addition, the suretyship terminates one year after the expiry date of the secured obligation unless the suretyship agreement provides for other terms. Therefore, a creditor's claim arising out of a suretyship agreement may not be satisfied in the course of the insolvency proceedings of the surety if the creditor has missed the relevant time limits.[145]

As addressed above,[146] if a settlement agreement is reached in the principal debtor's insolvency proceedings where it changes the terms of the principal debtor's obligations and excludes the debtor's late performance, the secured creditors' claims may not be excluded from the register in the surety's insolvency proceedings.

It should be noted that the insolvency of the primary obligor does not affect the currency of the surety's obligation, the surety continues to be liable in the currency specified in the agreement.[147] However, if the surety is subject to insolvency proceedings, the claims are registered in its register at the rate established at the date of the introduction of the insolvency proceedings of the primary debtor.[148]

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139 Article 138(4) of the Insolvency Law; SC Ruling No 305-ES16-10852(3), dated 20 November 2017.
140 Article 138(4.1, 4.2) of the Insolvency Law.
141 *See* Articles 363 and 323 of the Civil Code.
142 Article 367 (1) of the Civil Code.
143 SC Ruling No 46-KG19-14, dated 9 July 2019, and No 304-ES18-26241, dated 13 June 2019.
144 SC Ruling No 303-ES16-6738, dated 8 September 2016.
145 Article 367(6) of the Civil Code; Resolution of the Constitutional Court of the Russian Federation No 18-P, dated 15 April 2020.
146 See section 4.5 above; SC Ruling No 305-ES18-11645 (3), dated 28 May 2020.
147 SC Ruling No 305-ES16-19525, dated 20 April 2017.
148 SC Rulings No 305-ES16-11412, dated 26 September 2016; and No 305-ES16-13148, dated 24 August 2016.

10. What happens to secured creditors who have not complied with all the required processes for protecting their secured rights?

If a creditor has not taken measures to protect its secured rights, it is at risk of losing the benefits of its secured creditor status.

As noted, it is necessary to register a pledge of movables and receivables in the Pledge Register to ensure that the pledge is effective against third parties. Therefore, in the absence of such registration, the creditor does not have the status of a secured creditor, unless it can prove that the other creditors of the insolvent debtor / pledgor were aware of or should have been aware of the pledge.[149] The creditor can record its pledge after the insolvency proceedings have been initiated. However, there is a risk that such action will be set aside as a preferential transaction. It should also be noted that a creditor loses the right of pledge if the pledged asset is sold to a *bona fide* purchaser (which is more probable in the event that the pledge is not registered).

In the absence of the registration, which is required to make the pledge effective, the creditor will not be considered as a secured creditor.[150]

See also section 8 above for other consequences of the creditor's failure to take measures to protect its secured rights.

11. During a pre-insolvency or insolvency proceeding, is the secured party permitted to foreclose or take other enforcement actions against the collateral? Does this stay apply to all claims against the debtor? Can the stay be challenged? If so, how?

According to the Insolvency Law,[151] from the date when the supervision procedure commences, all monetary claims as well as claims for foreclosure of the pledged assets must be brought against a debtor in the insolvency proceedings. Likewise, as of the same date, enforcement proceedings against a debtor are stayed.

This does not prevent the court from rendering a decision on foreclosure of the pledged assets if a claim has already been filed with a court before the commencement of the supervision procedure and the creditor has not applied for a stay. However, such a court decision may be enforced only during the course of the insolvency.[152]

See also section 6 above.

11.1 Challenging the stay

The stay is automatic and takes effect by operation of law. Therefore, it may not be appealed separately from appealing the court ruling on the introduction of the supervision procedure.

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[149] Clause 8 of the Recommendations of the scientific advisory board of the Commercial Court of the West Siberian Circuit approved on 26 April 2019.

[150] Although, there was a case where the status of a secured creditor was recognised in relation to unregistered immovable property (an unfinished construction, provided that the lease rights to the underlying land plot were mortgaged); see SC Ruling No 306-ES17-3016(2), dated 14 August 2017.

[151] Articles 18.1(1), 63(1) of the Insolvency Law.

[152] Clause 6 of the SCC Plenum Resolution No 58, dated 23 July 2009.

12. Can collateral in which a secured party has an interest be used by the debtor or sold during a case without the consent of the secured party? If collateral may be sold without the secured party's consent, may it be sold "free and clear" of the liens of the secured party?

Are there specific rules regarding the debtor's use of "cash collateral" as opposed to other types of collateral?

In the case of a non-possessory pledge, the pledgor can generally continue using the pledged assets in its business operations. At the same time, as a rule, an insolvent debtor is not allowed to sell, lease, or otherwise dispose of, or encumber the pledged assets without the secured creditor's consent.[153] If the pledged asset is nevertheless sold without the creditor's consent, the pledge should still survive (unless the asset is acquired by a *bona fide* purchaser who was not aware of the pledge).

Interestingly, if the pledged asset is in the possession of the pledgee (which is not that widespread in practice), and then it is lost against the pledgee's will, the pledge should survive even if the asset has been acquired by a *bona fide* purchaser who was not aware of the pledge.[154]

The following should be noted with respect to cash collateral. In the case of a pledge of a bank account, the creditor can send a notice to the bank to prevent further withdrawals from the pledge account (i.e. effectively freeze the account for the amount which is equivalent to the secured debt).[155] If the pledgee enters into financial rehabilitation or external management (which is rare), the creditor can satisfy its claims by way of the withdrawal of funds from the pledge account – up to the total amount of funds available in the account, but not exceeding the amount of the secured debt, subject to court authorisation (as specified in section 6 above). During receivership, withdrawal of funds from the pledge account is permitted in the amount of up to 70% (or 80%) of the funds available in the account but not exceeding the amount of the secured debt.

13. During the course of a pre-insolvency and insolvency proceeding, can additional liens on a secured creditor's collateral be granted to a third party in violation of the contractual arrangements between the debtor and the secured creditor?

An insolvent pledgor can only grant additional contractual security rights over the secured creditor's collateral with the consent of the secured creditor (unless otherwise provided for by law or in the pledge agreement).[156]

Non-contractual security rights over the secured creditor's collateral may arise by virtue of law, including those arising as a result of an attachment imposed by the tax authorities. However, such security rights should be in a lower order of priority to the existing ones, which are properly registered or known to the non-contractual security rights holder (see also section 7 above).

14. What distribution will a secured creditor receive if a company is reorganised?

Where a reorganisation takes the form of substituting a debtor's assets, the pledge of assets contributed to the share capital of the newly established company is replaced with a pledge over the shares in this company. The value of the shares to be pledged must be equal to the market value of the pledged assets contributed to the share capital.[157] The pledged shares in the newly established company are part of the

[153] Article 18.1(4) of the Insolvency Law.
[154] Clause 25 of the SCC Plenum Resolution No 10, dated 17 February 2011.
[155] Article 358.12(4) of the Civil Code.
[156] Article 18.1(4) of the Insolvency Law.
[157] Articles 115 and 141 of the Insolvency Law.

bankruptcy estate and secured creditors must receive the proceeds of their sale in accordance with the general rules applicable to pledged assets discussed above.

15. Will the rights of a secured creditor over assets of a debtor remain intact subsequent to the reorganisation of the company?

As a result of a reorganisation involving the substitution of a debtor's assets (see section 14), a buyer

will be able to acquire shares in the company whose property is unencumbered and attract financing secured by the pledge of such property.

For the purposes of enhancing the guarantee for creditors' rights, the sole executive body of the newly established company will be an external administrator or a receiver. Another person may be appointed to this position following a decision of the creditors at the creditors' meeting. The creation of a collegial management body and approval of the company's articles of association are within the competence of the creditors' meeting or the creditors' committee. The newly established company is not entitled to dispose of property that has been contributed to its share capital until all of its shares are realised in the course of the insolvency procedures.

16. What rights does a secured creditor have if its secured claim is over-secured? What happens if a secured claim is under-secured?

The fact that the value of the pledged property significantly exceeds the amount of the creditor's claims *per se* does not mean that it is possible to challenge the transaction. When the court accepts a creditor's claim, it takes into account that the claim is secured by a pledge, regardless of the value of the pledged property.[158] In respect of a third-party pledge, the amount of secured creditors' claims recorded in the register of creditors' claims of the insolvent pledgor is determined based on the value of the pledged property as specified in the pledge agreement or the court decision authorising the foreclosure.[159] Where a claim is over-secured, after the pledged property has been disposed of at an auction as established by law, the amount by which the creditor's claim is over-secured (after payment of principal, interest and costs) must be transferred to the bankruptcy estate to be used to satisfy the claims of the other creditors in the relevant order of priority.[160]

If the secured creditor's claims are under-secured, the unsecured portion of such creditor's claim will be ranked alongside the third-priority unsecured creditors on a *pro rata* basis without any preference.[161]

The Supreme Court clarified that, if a secured creditor's claims are under-secured, the insolvency administrator cannot distribute monetary funds received prior to the enforcement of pledges only among non-secured creditors: these proceeds have to be reserved and distributed among all creditors, including the secured creditors.[162]

17. Will a court give full force and effect to a foreign restructuring of contractual arrangements that are governed by local law? If so, what requirements will need to be met for the court to do so?

Russian court practice has not developed any rules similar to the Gibbs Principle. Therefore, if a foreign restructuring of contractual arrangements governed by Russian law was carried out with the consent of the

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158 Resolution of the Commercial Court for the North-Western Circuit No A56-14458/2019, dated 3 March 2020.

159 Although, if the sale proceeds exceed the registered amount of the claims against the third-party pledgor, they are used towards the discharge of the secured creditors' claims in full (Clause 20 of the SCC Plenum Resolution No 58, dated 23 July 2009).

160 Article 138 (2.1) of the Insolvency Law.

161 Ibid.

162 SC Ruling No 310-ES18-17700 (2), dated 11 July 2019.

parties to those arrangements, a Russian court may give them effect subject to a valid choice of foreign law for those contractual arrangements. If a foreign restructuring was carried out in the form of a court-approved restructuring without the consent of the relevant creditor, a Russian court may give it effect only if the foreign decision on the debt restructuring is recognised and enforced by the Russian court.

In general, foreign court judgments are recognised on the grounds of international treaties and, absent such treaties, on the grounds of comity and reciprocity. However, recognition of foreign judgments related to restructuring proceedings in Russia may require proof of mutual recognition of Russian insolvency judgments in the relevant foreign jurisdiction. Generally, a Russian court's approach to recognition of foreign court judgments on restructuring proceedings has been inconsistent. Between 2010 and 2014, Russian courts recognised three Kazakh judgments on restructuring proceedings in respect of Kazakh banks.[163] However, in a more recent case, Russian courts refused to recognise an Azerbaijani court decision on the restructuring of the debts of an Azerbaijani bank upon request from its creditor, a Russian bank. They found, among other things, that (1) unilateral (even partial) write-off of a Russian bank's debt contravened Russian public policy and (2) recognition of foreign judgments on restructuring in Russia required proof of mutual recognition of Russian insolvency judgments in Azerbaijan.[164]

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[163] Rulings of the Moscow Commercial Court No A40-24334/10-25-170, dated 23 April 2010 (not appealed); No A40-108389/2012, dated 15 October 2012 (not appealed); No A40-53374/14, dated 24 July 2014 (not appealed). The courts granting such relief relied on the multilateral Kiev Treaty on Settling Disputes Related to Commercial Activities (dated 20 March 1992).

[164] See Resolution of the Commercial Court for the Moscow Circuit No A40-185979/2017, dated 8 November 2018 (petition for review by the SC denied).

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