

AMENDMENTS TO PLEDGE LEGISLATION

February 1, 2009

To Our Clients and Friends:

On December 30, 2008 the State Duma adopted Federal Law No. 306-FZ on Amendments to Certain Legislative Acts of the Russian Federation to Improve the Process of Foreclosure on Pledged Property (**Law 306-FZ**). The amendments introduced by Law 306-FZ came into effect on January 11, 2009 and apply to legal relations arising after the effective date of the amendments.¹

Law 306-FZ has the effect of amending the Russian Civil Code (**Civil Code**), Law of the RF No. 2872-1 dated May 29, 1992 on Pledge (**Law on Pledge**), Federal Law No. 102-FZ dated July 16, 1998 on Mortgage (Pledge of Property) (**Mortgage Law**), Federal Law No. 127-FZ dated October 26, 2002 on Insolvency (Bankruptcy) (**Bankruptcy Law**), Fundamentals of the Law of the Russian Federation on the Institution of Notary No. 4462-1 dated February 11, 1993, Federal Law No. 229-FZ dated October 2, 2007 on Execution of Legal Process, Federal Law No. 122-FZ dated July 21, 1997 on State Registration of Rights to Immovable Property and Transactions Therewith, and Federal Law No. 196-FZ dated November 2, 2007 on Pawnshops (**Pawnshop Law**).

These amendments are generally geared towards the protection of the pledgee's interests and provide for a more simplified procedure for the foreclosure and sale of pledged property, and for the first time detailed procedures have been elaborated for foreclosure on pledged property without involving the courts, which will ensure that pledge can more effectively be used as a tool to secure an interest under Russian law.

MOVABLE PROPERTY

Grounds for foreclosure on the pledged property

As before, foreclosure on pledged property may be undertaken on the grounds of failure by the debtor to perform or duly perform the obligation secured by the pledge for which the debtor is liable. However, Law 306-FZ sets forth certain cases when the pledgee acquires the right to foreclose on the pledged property before or after the established date for performance of the secured obligation or when foreclosure is expressly prohibited.

Early foreclosure. Early foreclosure is allowed, for example, in the case of foreclosure on pledged property under a claim secured by a subsequent pledge. In such cases, performance of the obligation

¹ The provisions of Law 306-FZ apply, *inter alia*, to foreclosure on grounds that came into being after the effective date of Law 306-FZ.

secured by the second pledge may be called in early, with simultaneous foreclosure on the property, even though the claim secured by the first pledge is not yet due.²

Grace period. Another example: as before, the law envisages that on the petition of the pledgor, if reasonable grounds exist, a court may order a grace period on foreclosure of up to 1 year; however, Law 306-FZ goes further and specifies circumstances in which such grace period cannot be given (e.g., where there is a risk of a significant fall in the price of the pledged property or if at the end of the grace period the pledgee's claim amount could be expected to exceed the value of the pledged property). A grace period may also be provided according to the terms of the agreement between the pledgor and pledgee.

Prohibition on foreclosure. Law 306-FZ sets forth criteria for judging whether a pledgor's default on obligations may be deemed negligible, in which case foreclosure is not permitted. In the previous version the wording of Article 348.2 of the Civil Code was limited to two criteria: the default must be "extremely negligible" and "the resulting claims of the pledgee [must be] clearly not commensurate with the value of the pledged property", which left the matter of prohibiting foreclosure proceedings to the discretion of the court. In the new wording of Article 348.2 of the Civil Code, unless proven otherwise, the default is deemed negligible and neither court-ordered nor any other kind of foreclosure is permitted if all of the following criteria are satisfied:

- the amount of the default is less than 5 percent of the value of the pledged property as set forth in the pledge agreement;
- the default period is less than three months.

In addition, Law 306-FZ borrows from the approach taken by the Mortgage Law and introduces an additional rule for establishing the negligibility of a default on an obligation in the form of recurring payments: unless the pledge agreement provides otherwise, foreclosure on property pledged as security for the performance of such obligation is permitted in the event of a systematic default on the payments schedule, i.e., failure to make timely payments more than three times in a twelve-month period, even if each delay is insignificant.

It is important to note that the basic negligibility criteria apply unless otherwise proven, while the negligibility criteria relating to obligations in the form of recurring payments apply only if the parties have not provided otherwise in the pledge agreement. However, in the absence of any clarifications or case law on the matter it is not quite clear whether the possibility of providing "otherwise" in the pledge agreement implies that the negligibility criterion relating to recurring payments can be

² *If the pledgee under the first pledge agreement has not exercised such right, the property being foreclosed under the subsequent pledge passes to the acquirer as property encumbered by the first pledge.*

superseded, or whether the lawmakers were simply allowing for the possibility of changing the frequency or period of violations in respect of which such default would be deemed negligible.

Foreclosure procedure

Foreclosure on pledged property may be court-ordered or other.

As before, a court-ordered foreclosure remains the primary procedure to apply unless the pledgor and the pledgee have agreed otherwise, but Law 306-FZ provides that an agreement between the pledgor and pledgee on foreclosure that is not court-ordered (in all cases, not merely mortgage, as may ensue from the current language of the Civil Code) may be executed at any time, including at the time the pledge agreement is executed or after grounds for foreclosure have arisen. This agreement may be in the form of a separate agreement or it may be incorporated in the pledge agreement.

If the pledgor is a natural person, such agreement on foreclosure that is not court-ordered may be executed only if the pledgor provides notarized consent to extrajudicial foreclosure on the pledged property.

In addition, it should be noted that, as before, in certain cases foreclosure on movable property must be court-ordered. Law 306-FZ clarifies and supplements the list of such cases, which now also includes cases where:

- the execution of the pledge agreement in respect of property belonging to a natural person requires the consent or approval of another person or body (previously this rule also applied to legal entities, which meant that extrajudicial foreclosure would not have been allowed in the case of pledge agreements entered into by legal entities that were classified as, for example, interested party or major transactions, or in the case of pledge agreements in respect of participation interests in limited liability companies³);
- the property being pledged has special historical, artistic or other cultural value to society;
- the pledgor is missing and the pledgor's whereabouts cannot be ascertained;

3 Here it must be kept in mind that, in the case of foreclosure on pledged participation interests in limited liability companies that is not court-ordered, and in the case of sale of such participation interests by any means other than by auction, the preemptive right of the other participants in the company to acquire the participation interest and any other restrictions on the disposal of participation interests that may be provided by the charter of the company remain unregulated.

- the law does not permit foreclosure that is not court-ordered;⁴ or
- the pledge agreement or other agreement between the pledgor and pledgee does not establish a foreclosure procedure in respect of the pledged property or the foreclosure procedure established by the parties is not permitted (the wording of the law does not make it clear whether this rule will apply if the pledge agreement or other agreement between the pledgor and pledgee completely omits the foreclosure procedure or in cases where certain issues relating to foreclosure that is not ordered by a court remain outside the scope of the agreement between the pledgor and pledgee (e.g., the starting sale price is not provided)).

Means of sale of pledged property

Court-ordered sale. Law 306-FZ clarifies that in the event of a court-ordered sale of pledged property such property must be sold at a public auction held pursuant to Russian legislation on the execution of legal process. As an important new development, Law 306-FZ has amended one of the most important rules of the Federal Law on Execution of Legal Process to provide that the pledgee's claims (all claims; rather than just those arising pursuant to established law, as it was before) will be satisfied out of the value of the pledged property without regard to the priority established by the Federal Law on Execution of Legal Process if the recovered amount is not sufficient to satisfy all claims of the creditors.

Extrajudicial sale. In the event of a sale of pledged property without the involvement of the courts, if any party to the pledge agreement is a natural person not registered as an individual entrepreneur, such pledged property may be sold only by way of:

- an auction; or
- sale under a commission agency agreement executed between the pledgee and the commission agent.

One of the most important new rules introduced by Law 306-FZ is that if both parties to the pledge agreement are legal entities or individual entrepreneurs they may provide for one of the means of foreclosure stated above or agree that the pledged property will:

- become the property of the pledge;⁵ or

⁴ For example, under the Bankruptcy Law, foreclosure that is not court-ordered is not permitted if the result of an oversight.

⁵ Moreover, it remains possible, as before, for the pledgor and the pledgee to make a termination fee agreement or a novation agreement which would provide for the pledged property to pass to the ownership of the pledgee.

- be sold by the pledgee directly to a third party.

Law 306-FZ adds significant detail and regulation to the procedure of extrajudicial sale of pledged property. In particular, Law 306-FZ provides that:

- the pledgee must give *notice of foreclosure* on the pledged property to the pledgor (or procure that the auction holder gives such notice), and such notice must contain all material information required by the Law on Pledge. Generally, the pledged property may not be sold before the expiry of 10 days after receipt of the notice by the pledgor or, if it occurs earlier, 45 days after the date such notice was sent to the pledgor by the pledgee or the auction holder;
- The parties may agree upon *a period during which the pledged property may be sold beginning on the date determined pursuant to the procedure described above on which the foreclosure was initiated*. Upon expiry of such period the pledgee may still seek a judicial foreclosure. If no such period is agreed between the pledgor and the pledgee, the sale of movable property must occur within a reasonable period.
- For the purposes of sale of movable property at an auction or under a commission agency agreement *the pledgee may enter into any necessary transactions within its legal capacity, in particular, with the auction holder and the valuer, and execute any and all instruments required to sell such movable property*, including acceptance statements and instruments of transfer. However, Law 306-FZ does not extend this provision to a direct sale to a third party without a commission agency agreement or transfer of the pledged property to the pledgee's ownership. Therefore, there is no clarity as to how these means of foreclosure will be applied in case of a dispute.

In the event of a sale of pledged property at auction, in addition to the notice of foreclosure, the pledgee must also give *an auction notice* to the pledgor and the principal debtor. Such notice must be given at least 10 days prior to the date of the auction, which is a reduced notice period as compared to the general 30 days' period of notification of a forthcoming auction provided by the Civil Code.⁶ Law 306-FZ does not provide for any specific order of giving a foreclosure notice and an auction notice in respect of movable property as opposed to immovable property. Since the same rules in respect of notice period apply to both notices, the foreclosure notice and the auction notice may be given simultaneously.

In the event of foreclosure on the pledged property by sale to a third party, the pledgee is not required to give an auction notice, but it must provide the pledgor with a copy of the sale agreement to be executed with the third party, certified by the pledgee .

⁶ Article 448.2 of the Civil Code. A reduced notice period of 10 days also applies, *inter alia*, to the court-ordered foreclosure procedure.

The pledge agreement (agreement on extrajudicial foreclosure) should provide for an *initial price* of sale or a procedure for its determination. If the parties provide for a valuer to be engaged for the sale of movable property that is not court-ordered, the starting sale price of the pledged property at the auction will be set equal to 80% of the market value of such property as determined in the valuer's report, unless otherwise agreed by the parties in the foreclosure agreement. Therefore, the 80% rule is envisaged to protect the pledgor only and the parties may agree a different price, even if the law requires that an independent valuer be engaged.

In addition to circumstances in which evaluation of property owned by the Russian Federation, its constituent subjects or municipalities is required for consummation of any transaction therewith as described in Federal Law No. 135-FZ on Evaluation Activity in the Russian Federation dated July 29, 1998 (**Law on Evaluation Activity**), Law 306-FZ further provides that, upon extrajudicial foreclosure on pledged movable property, a valuer is required to be engaged in the event of sale of:

- securities not traded on a regulated securities market;
- vested interests, with the exception of receivables not subject to auction;⁷
- precious metals, gemstones, jewelry and precious metals scrap;
- collectible currency in Russian rubles and foreign currency;
- items of special historical or artistic value;
- items with pledge value exceeding RUB500,000.

In addition, an independent valuer must be engaged for sale of pledged property pursuant to a commission agency agreement, as the sale price of the pledged movable property must be equal to the market value of such property reported by the valuer pursuant to Article 28.2 para 2 of the Law on Pledge. However, due to the inconsistency of provisions of Law 306-FZ, this requirement may be interpreted as being similar to the 80% rule applicable to the sale of property at an auction, i.e.

7 Due to the special legal nature of shares in the charter capital of limited liability companies, there are reasons to believe that the valuer similarly also must be engaged in the event of a sale of pledged shares in the charter capital of limited liability companies. Due to special legal nature of uncertificated securities, it can also be argued that shares are vested interests and, therefore, in the event of their sale a valuer must also be engaged. In addition, we believe that based on formal reading of the Civil Code rules governing uncertificated securities and systemic interpretation of Law 306-FZ, a valuer must also be engaged in the event of sale of shares which are not traded on a stock exchange. If the shares are traded on a stock exchange, there are two possible scenarios: (1) the pledged shares will be sold through the stock exchange whereby the pricing mechanism of the stock exchange will supersede the requirement to engage a valuer (though it may be argued that a valuer still must be engaged if the value of the pledged shares exceeds RUB500,000) or (2) the pledged shares will be sold to the pledgee or a third party (including pursuant to a commission agency agreement) whereby the valuer will be required to be engaged only if the value of the pledged shares exceeds RUB500,000.

that in the event of sale of pledged property pursuant to a commission agency agreement an independent valuer will be required to be engaged only in circumstances described in the law (see above) and the sale price will be equal to the price reported by the valuer. It might be assumed that in the event of a sale of pledged property pursuant to a commission agency agreement there is no fair pricing mechanism in the form of an auction and it would be correct to interpret the above rule as requiring engagement of a valuer. We note, however, that Law 306-FZ does not establish a similar rule for a direct sale of pledged property to a third party, despite no fair pricing mechanism being available, similar to an auction (it is envisaged in respect of direct sale to a third party that the price of the pledged property must be equal to its market value). In the event of foreclosure on the pledged movable property by way of transfer to the pledgee, such movable property must be transferred to the pledgee at a price equal to its market value.

In the event of a sale of pledged movable property at auction, the auction holder may declare that the *auction has failed* if:

- less than two bidders participated in the auction;
- no bids higher than the starting sale price of the pledged movable property were made at the auction;
- the winning bidder has failed to pay the purchase price on time.

As before, Law 306-FZ provides that, subject to satisfaction of certain provisions of law, the auction may be held twice, and the *pledgee may retain the pledged property* at any time, however, if the first auction failed the pledgee may do so only by agreement between the pledgor and the pledgee, and if a subsequent auction failed – at the pledgee’s discretion. If the pledgee does not exercise its right to retain the pledged property for one month after the date on which the second auction was declared to have failed, the pledge agreement will terminate.

Though it is not expressly provided for in Law 306-FZ, it would be reasonable to assume that the procedure for sale of the pledged property by its transfer to the pledgee will be similar to that of transfer of the pledged property to the pledgee upon failure of the first auction (and similar to the rule applicable to mortgage agreement), i.e. pursuant to a sale agreement, however, it would be appropriate to include provisions governing such sale into the foreclosure agreement.

As before, monetary funds remaining after satisfaction of the pledgee’s claims should be transferred to the pledgor. If the proceeds from the sale of the pledged property are not sufficient to satisfy the pledgee’s claims the pledgee may (unless otherwise provided by law or contract) recover the balance from other property of the pledgor in the general order of priority.

Foreclosure on securities

Law 306-FZ provides for a special means of foreclosure on securities traded on a regulated securities market. Such securities may only be sold through trading on a stock exchange. The language of Law 306-FZ is not clear whether such special means of foreclosure applies only to the sale of pledged property at auction or should also apply in the event of sale pursuant to a commission agency agreement.⁸ Law 306-FZ may also be read to require that such special means of foreclosure on publicly traded securities (only through trading on a stock exchange) apply at all times effectively prohibiting foreclosure on the publicly traded securities by way of a direct sale to a third party or transfer to the ownership of the pledgee. However, in our opinion, such restrictive interpretation of Law 306-FZ is unlikely and is not consistent with the general concept of Law 306-FZ and a number of its specific provisions.

An important new rule introduced by Law 306-FZ in respect of securities is that the requirements of Article 84.2 (obligatory tender offer to purchase shares in a company by any person acquiring over 30% of the shares in such company) of Federal Law No. 208-FZ on Joint Stock Companies dated December 26, 1995 will not apply until January 1, 2010 with respect to any acquisition by:

- financial institutions of shares in open joint stock companies where such shares were pledged to secure obligations to such financial institution, as a result of foreclosure on the shares or as a termination fee;
- third parties from a financial institution of shares in open joint stock companies where such shares were pledged to secure obligations to the financial institution and were acquired by such financial institution as a result of foreclosure on the shares or as a termination fee; and
- third parties of shares in open joint stock companies where such shares were pledged to secure obligations to a financial institution and were sold at auction or to a third party as a result of foreclosure on the shares or as a termination fee.

Therefore, amid the current financial crisis, Law 306-FZ significantly facilitates acquisition of pledged securities by financial institutions, exempting them (and other persons that will purchase such securities from the financial institutions) from the financial burden of a mandatory tender offer to existing shareholders of the company whose shares were pledged.

8 In addition, requirement to sell at a stock exchange may in some instances conflict with the rule requiring to engage an independent valuer if the value of the pledged property exceeds RUB500,000.

IMMOVABLE PROPERTY

Grounds for foreclosure on the mortgaged property

As in the case of a pledge of movable property, foreclosure on mortgaged property may be undertaken only upon failure to perform or duly perform the obligation secured by the mortgage, except where foreclosure is permitted by law before the established date for performance of the secured obligation (e.g. upon foreclosure under a previous or subsequent mortgage), or a grace period is given, or foreclosure is expressly prohibited.

Negligibility of the default on a secured obligation remains one of the grounds for prohibiting foreclosure. Law 306-FZ sets forth criteria for judging whether a mortgagor's default under a mortgage may be deemed negligible, which are exactly the same as the negligibility criteria established for a pledge. However, it is worth noting that, in contrast to the rules applicable to pledge, negligibility criteria relating to obligations in the form of recurring payments apply with respect to a mortgage only if the foreclosure is court-ordered.

Foreclosure procedure

Foreclosure on mortgaged property may be court-ordered or extrajudicial.

As before, a court-ordered foreclosure remains the primary procedure that will apply unless the mortgagor and the mortgagee have agreed otherwise, but Law 306-FZ establishes specific criteria for the agreement between the mortgagor and mortgagee with respect to extrajudicial foreclosure. Law 306-FZ establishes that an agreement on out-of court foreclosure may be executed at any time, including at the time the mortgage agreement is executed, and not only after grounds for foreclosure have arisen, as was the case before.

Such agreement on extrajudicial foreclosure on the mortgaged property is no longer required to be notarized, but it may instead be executed subject only to the notarized consent of the mortgagor to extrajudicial foreclosure on the mortgaged property, and the mortgagor's consent may be obtained prior to execution of the mortgage agreement.

In addition, it should be noted that, as before, in certain cases foreclosure must be court-ordered. Law 306-FZ clarifies and supplements the list of such cases, which now also includes cases where:

- the execution of the mortgage agreement in respect of property belonging to a natural person requires the consent or approval of another person or body (as in the case of a pledge of movable property, this rule now applies to natural persons only);
- the property being mortgaged comprises of residential premises owned by natural persons;

- the property being mortgaged comprises of property owned by the government or municipalities.

Means of sale of mortgaged property

Court-ordered sale. Law 306-FZ clarifies that in the event of a court-ordered sale of mortgaged property such property must be sold at auction held pursuant to the Russian legislation on execution of legal process.

Extrajudicial sale. As before, the mortgagee and the mortgagor may agree that:

- the mortgaged property will be sold at auction; or
- the mortgaged property will be acquired by the mortgagee for itself⁹ or for third parties where the mortgagee's claims to the debtor secured by mortgage will be offset against the purchase price (such agreement may not provide for the purchase of mortgaged property by the mortgagee if the mortgaged property is comprised of land).¹⁰

Law 306-FZ adds significant detail and regulation to the procedure of extrajudicial sale of mortgaged property. In particular, Law 306-FZ provides that:

- prior to holding an auction, the auction holder or the mortgagee must give a *notice with request to perform the obligation* secured by mortgage to the mortgagor. If the requirements set forth in an auction notice are not complied with within 10 days after receipt of the notice by the mortgagor or, if it occurs earlier, 45 days after the date such notice was sent to the mortgagor by the mortgagee or the auction holder, the auction holder will give an auction notice to the mortgagee and the mortgagor and will publish an *auction announcement*. The auction may not be held before the expiration of 10 days after the auction announcement was first published.
- After the date of the first publication of the auction announcement *the mortgagor may not enter into transactions involving mortgaged property* (except for transactions with the mortgagee for the purpose of terminating the obligation secured by mortgage). If such transactions were made they may be held invalid by court upon petition of any interested party.

⁹ If the mortgagee retains mortgaged property that is of such nature or purpose that it may not be owned by it, including property of significant historical, artistic or other cultural value to society, or land, the mortgagee must dispose of such property within one year.

¹⁰ In addition, it remains possible, as before, for the mortgagor and the mortgagee to enter into a termination fee agreement or novation agreement, which would provide for the mortgaged property to pass to the mortgagee.

- For the purposes of sale of the mortgaged property at auction *the mortgagee may enter into any necessary transactions within its legal capacity, in particular, with the auction holder and the valuer, and execute any and all instruments required to sell such mortgaged property*, including acceptance statements. Upon a written request of the mortgagee, within 3 business days after such request was made, *the mortgagor must deliver all document to the mortgagee* that are required to transfer the mortgaged property to the ownership of the winning bidder.

As before, the auction holder will declare that the auction has failed if:

- fewer than two bidder participated in the auction;
- no bids higher than the starting sale price of the mortgaged property were made at the auction;
- the winning bidder fails to pay the purchase price on time.

As before, Law 306-FZ provides that subject to satisfaction of certain provisions of law, the auction may be held twice, and *the mortgagee may retain the mortgaged property* at any time, however, if the first auction failed the mortgagee may do so only by agreement between the mortgagor and the mortgagee, and if a subsequent auction failed – at the mortgagee’s discretion. If the mortgagee does not exercise its right to retain the mortgaged property within one month after the date on which the second auction was declared to have failed, the mortgage agreement will terminate.

The agreement on purchase of the mortgaged property by the mortgagee is subject to the provisions of the civil legislation of the Russian Federation applicable to a purchase agreement, and in the event of a purchase of property for third parties – applicable to commission agency agreement as well. The Mortgage Law does not provide for any other conditions that must be met by the mortgagee to purchase the mortgaged property, or for its sale to third parties without an auction.

The mortgage agreement (agreement on extrajudicial foreclosure) should provide for an *initial price* of sale or a procedure for its determination. If the parties provide for a valuer to be engaged for an extrajudicial sale of the mortgaged property, the starting sale price of the mortgaged property at the auction will be set equal to 80% of the market value of such property as determined in the valuer’s report, unless otherwise agreed by the parties in the foreclosure agreement. Therefore, the 80% rule is envisaged to protect the mortgagor only and the parties may agree a different price, even if the law requires that an independent valuer be engaged.

Law 306-FZ, in addition to circumstances described in the Law on Evaluation Activity, further provides that upon extrajudicial foreclosure on immovable property a valuer is required to be engaged in the event of:

- foreclosure a leasehold interest in immovable property;

- foreclosure on rights ensuing from agreement for participation in shared construction;
- foreclosure on immovable property with a value of over RUB500,000 pursuant to a mortgage agreement.

As before, monetary funds remaining after satisfaction of the mortgagee's claims should be transferred to the mortgagor. If the proceeds from the sale of the mortgaged property are not sufficient to satisfy the mortgagee's claims the mortgagee may (unless otherwise provided by law or contract) recover the balance from other property of the mortgagor in the general order of priority.

GENERAL ISSUES OF FORECLOSURE

Limitation of fee payable to the auction holder

The fee payable to the auction holder (or commission agent in the event of foreclosure on movable property) out of the proceeds from sale of pledged property at auction, or pursuant to a commission agency agreement, may not exceed 3% of the value of such property. Fees in excess of such amount must be paid by the pledgee.

Executive notary endorsement

Law 306-FZ provides that a foreclosure agreement can be enforced pursuant to an executive notary endorsement without involving the courts if the following conditions are satisfied:

- the debt or other liability of the pledgor to the pledgee is not disputable as confirmed by submitted documents; and
- the period of limitation has not expired in respect of such claim.

The pledgor may challenge such foreclosure within 7 days. The notary will review such challenge as to whether the pledgor's claims meet the undisputability criteria and will sustain it if the notary finds that there is reason to believe that the debt is not undisputable.

In the absence of challenge, the notary will perform executive notary endorsement which has the power of a writ of execution and can be enforced pursuant to the provisions of the legislation on execution of legal process.

Change of status of pledge creditors upon bankruptcy

Extrajudicial foreclosure on the pledged property is not permitted after the date when oversight is imposed; however, the pledgee may seek foreclosure on the pledged property if a company is in the process of financial restructuring or placed under receivership, but before the debtor is declared bankrupt and liquidation in bankruptcy proceedings are initiated. If the court agrees to permit foreclosure, the pledged property will be sold at auction. If the proceeds from sale are not sufficient

to satisfy the pledgee's claims the outstanding claims will be satisfied along with the claims entitled to third priority.

The Bankruptcy Law, which has been amended to protect the pledgee's interests, now provides that the pledgee, rather than waiting until its claims are satisfied as claims entitled to third priority of payment, will now have access to a greater portion of proceeds from sale of the pledged property along with creditors with claims entitled to first and second priority. If the pledgee failed to exercise or waived its right to foreclosure on the pledged property before the debtor was declared bankrupt, the pledged property will be subject to sale at auction in the course of liquidation in bankruptcy and the proceeds will be applied as follows: 70% - to satisfy the pledgee's claims (regardless of claims of other priorities), 20% - to satisfy claims entitled to first and second priority and 10% - to cover court costs and other expenses. If obligations under a loan agreement were secured by a pledge, 80% of the proceeds will be applied to satisfy the pledgee's claims, 15% - to satisfy claims entitled to first and second priority, and 5% - to cover court costs and other expenses.

The monetary funds remaining after the claims entitled to first and second priority have been satisfied will be applied to meet claims of the pledgee. The monetary funds remaining after full satisfaction of the claims entitled to first and second priority and creditors' claims under obligations secured by a pledge will be included in the bankruptcy assets.

Creditors' claims under obligations secured by a pledge of the debtor's property which have not been satisfied out of the proceeds from the sale of such property will be satisfied along with the claims entitled to third priority.

We will be happy to answer your queries in respect of the foregoing or any other aspects of the civil legislation.

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