

Russia

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ACQUISITION OF REAL ESTATE

Legal system

1 How would you explain your jurisdiction's legal system to an investor?

Russia has a civil law system. The main regulation in the area of business relations (including real estate) is performed by the Civil Code of the Russian Federation, in four parts:

- part 1 (1994) – general provisions, ownership, obligations;
- part 2 (1998) – contracts;
- part 3 (2001) – inheritance and international private law;
- part 4 (2007) – intellectual property.

Real estate issues are mainly covered in part 1 (section 2) and in part 2 (chapters 30 and 34). Part 3 contains the conflict of laws regulations applicable when one party in a transaction is a foreigner or the object of the deal is located outside Russia.

Additionally relationships between foreign investors and Russian legal entities, citizens, state authorities and institutions, with respect to real estate deals, the registration of real estate, and the state registration of rights to real estate, are governed by specific codes, federal laws and other regulatory legal acts, in particular:

- the Land Code of the Russian Federation;
- the Tax Code of the Russian Federation;
- the City Planning Code of the Russian Federation;
- the Federal Law On the State Registration of Rights to Real Estate and Related Transactions;
- the Federal Law On the State Land Cadastre; and
- the Federal Law On Transfer of Land or Land Plots from One Category to Another.

State authorities of members of the Russian Federation (regional authorities) may also adopt laws and other legal acts related to issues connected with investment activities in the real estate field. Such laws and other legal acts are effective only in the territories of the respective members (eg, Moscow, Saint-Petersburg, Krasnodar region, Republic of Tatarstan, etc).

Any party may address a court to prevent an action by another. To obtain an injunction, strong argumentation shall be presented. Russian courts are reluctant to impose restrictions in the absence of substantial proof of misconduct by the other party. Courts rule only in accordance with relevant contractual provisions and applicable legislation, regulations, usages, etc. No equity judgments are available. Parol evidence is admissible though very widespread in commercial litigation and arbitration.

Contracts between Russian and foreign counterparts as well as contracts related with real estate must be made in writing,

otherwise they are considered invalid. Oral contracts are admissible only for minor transactions between Russian individuals. Oral contracts between Russian legal entities that do not relate to real estate issues are restricted, though enforceable under certain conditions and limitations.

Recording conveyance documents

2 What are the legal requirements for recording conveyance documents?

Pursuant to Russian Federation legislation, real estate ('immovable property') includes land plots, subsoil plots, solitary bodies of water and everything that is securely attached to land, ie, any objects that may not be relocated without incommensurate damage to their purpose, including forests, perennial plants, buildings and constructions. The main characteristic of real property is inseparable attachment to land. However, regardless of existing attachment to land, by virtue of direct stipulation of the law, real estate, also includes other property subject to state registration, namely aircraft, marine and river vessels, and space objects. In the housing sphere real estate includes apartments and elements of engineering infrastructure.

In the Russian Federation, real estate and related rights and transactions are registered separately. Registration rules are common throughout all Russian territory.

Currently, registration of land plots is performed by recording data of the plot, including on the real estate objects securely attached thereto, in the State Land Cadastre. One of the main documents of the Cadastre is the Unified State Register of Land. No transactions related to a land plot (or part of a land plot) are permitted until it has gone through such registration.

Objects of planning activities, in particular buildings and constructions, are additionally described and registered in the system for state registration of objects of city-planning activities.

However, the main information, namely the rights to any piece of real estate and data concerning restrictions on such rights are registered in the Unified State Register of Titles to Real Estate and Related Transactions (EGRP) during the process of state registration. On the basis of the data contained in this Register, information on rights to land plots and related restrictions is inserted in the Unified State Register of Land.

Real estate is described and individualised in cadastral and technical registrations. As a result of state registration of rights to real estate or related transactions, rights to individually defined real estate objects are acknowledged and confirmed by the state.

Cadastral and technical registration of real estate objects and the state registration of rights to real estate and related transactions are two closely interconnected procedures from the point

of view of investment activities that involve transactions to acquire the rights to various real estate. State registration which is required for acknowledgment and confirmation, commencement, termination and restriction of the rights to real estate, is performed on the basis of data received from state technical registration or inventory authorities.

Registration in the Unified State Register of Title to Real Estate and Related Transactions (either of the transaction itself or of the title transfer) is of vital importance for all real estate transactions.

Foreign investors

- 3** What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

According to the general rule of the Russian Federation Constitution, foreign citizens, legal entities and Russian legal entities whose share capital ownership interests are held by foreigners may acquire the same rights to land plots as Russian citizens and legal entities without foreign participation.

Agricultural land plots are the exception to this rule. Foreign parties (individuals and legal entities) and Russian legal entities with more than 50 per cent foreign share participation in their share capital may only lease agricultural land.

In addition, pursuant to the Land Code of the Russian Federation, foreign parties may not own rights to land plots located on border territories, the list of which is established by the president of the Russian Federation, and other specifically determined territories. At the time of publication, the list of such territories had not yet been determined. Until it is, the granting of any land plots located on border territories to foreign citizens, individuals holding no citizenship or foreign legal entities is prohibited.

No special reporting from foreign investors is required (except for statistics filings).

Foreign investors should bear in mind that during activities in Russia certain formal requirements for the signing of documents, filing, etc, must be met (eg, at the moment of local company creation or real estate title registration). Though they are common to both Russian and foreign businesses, some peculiarities exist. For instance, foreign documentation shall be accompanied by a certified translation into Russian, official documents shall carry an apostille, competence of the company's officials signing in its name shall be duly proven by a power of attorney or excerpt from a company register (or a similar document). Another specificity is that Russian companies and state authorities usually ask for a company stamp to be placed together with a signature in the documents.

Exchange control

- 4** If a non-resident invests in a property in your jurisdiction, are there exchange control issues? What about return of capital?

Russian legislation regulating foreign currency operations is intended to protect the national currency and prevent capital from being illegally exported. The main legislative act in this sphere is the Federal Law On Currency Regulation and Control, No. 173-FZ of 10 December 2006 (the Law on Currency Regulation). The regulatory instruments of the Central Bank of the Russian Federation are also of relevance, given that in accordance with the abovementioned Law the Central Bank is the main body for currency regulation in Russia.

The Russian currency legislation is currently undergoing significant changes owing to the overall liberalisation of the Russian

economy as well as the intention of the government to ensure conditions for a freely convertible rouble. In 2006 most restrictions connected with capital transfer transactions between Russian and foreign entities were lifted. In total the changes in the currency legislation of the Russian Federation ensure the gradual reduction of administrative barriers and a limitation of interference of public authorities into Russian and foreign businesses.

As a general rule, transactions between residents and non-residents as well as transactions solely between non-residents are conducted freely and without any restrictions. In particular, non-residents may transfer foreign currency without limitations to accounts opened in Russian banks or transfer foreign currency from accounts opened in Russian banks to those opened beyond the borders of the Russian Federation. Also, non-residents may freely conduct securities transactions. Transactions between residents and non-residents still require some filings to the Russian banks regarding the amount of money transferred abroad. If a foreign investor has created a subsidiary in Russia, the subsidiary company qualifies as a resident. According to article 140 of the Russian Federation Civil Code, transactions between the subsidiary and other Russian companies must be conducted in roubles. Therefore, agreements may refer to an amount expressed in a foreign currency, but the payments are to be made in its rouble equivalent.

Legal liability

- 5** What types of liability does an owner of real estate face? Is there a standard of strict liability and can there be liability to subsequent owners? What about tort liability?

Regulation of real estate owners' liability is quite superficial in Russia. Only general liability rules apply, stating that any personal or environmental damage shall be compensated by the violator. Additionally administrative fines and penalties are imposed for certain offences (up to 100,000 roubles – approximately US\$4,000 and suspension of the company's activities for 90 days).

While no broad court practice exists, the liability imposed on a real estate owner may pass to the subsequent owners.

Protection against liability

- 6** How can an owner protect itself from liability and what types of insurance can they obtain?

Current business and court practice on protection from liability is quite insufficient. Commercial insurance is available but not widespread. If the company is engaged in certain types of 'dangerous' activities (mining or construction, for instance) special obligatory insurance with government agencies is required.

Choice of law

- 7** How is the governing law of a transaction involving properties in two jurisdictions, one outside of your jurisdiction, chosen? What are the conflict of laws rules in your jurisdiction?

The general conflict-of-laws rule states (article 1211 of the Civil Code) that a contract shall be governed by the law of the jurisdiction most closely connected with the transaction (by default – the jurisdiction of the party engaged in most significant performance under the contract). Contracts related to real estate are presumed to be most closely connected with the jurisdiction where the immovable property is located. Still the parties are also free to choose the governing law for the transaction at their

own discretion (article 1210 of the Civil Code). Notwithstanding, contracts related to real estate located in Russia must be governed by Russian law.

As to the real estate rights, and their occurrence and cessation, the rules of the legislation where the real property is situated shall apply independently of contract choice of law provisions.

Subject-matter jurisdiction

- 8** Does subject-matter jurisdiction exist? Who are necessary parties? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Russian courts are authorised to hear and make a determination in a court action regarding real estate claims. In the absence of a provision specifying a forum, contract disputes are tried at the court of the region where the respondent is registered. For actions in rem only the court of the region where the real estate is located can resolve the case.

Claimant and respondent are the necessary parties, though personal presence in the court hearings is not usually required. For some disputes, state authorities (eg, registration agencies) are able to participate.

A special court appointment is required for out-of-jurisdiction service to be carried out by one of the parties. Otherwise it is performed through state authorities themselves. There is no need to be qualified in any way to be able to enforce remedies in Russia.

When entering into contract relations with Russian businesses, foreign investors should bear in mind that Russian state courts rather strictly view real estate claims as subject to their exclusive jurisdiction and unable to be submitted to arbitration either in Russia or abroad. This usually makes it impossible to enforce an arbitral award regarding Russian real estate in Russian state courts even in the presence of an arbitration clause in the contract. Accordingly it is not recommended to use arbitration for Russian real estate disputes if the enforcement is likely to take place in Russia.

Investment entities

- 9** What entities does your jurisdiction recognise? What are pass-through entities for tax purposes and what entities best shield ultimate owners from liability?

The Civil Code of the Russian Federation provides for various legal forms – general partnerships, limited partnerships, additional (or unlimited) liability companies, limited liability companies (LLC or ‘OOO’ in Russian), joint stock companies (JSC or the Russian abbreviation ‘AO’) and others. The Civil Code also provides for not-for-profit organisations of various types. The most common commercial organisations are joint stock companies and limited liability companies.

Joint stock companies

A joint stock company has shareholders and may engage in any form of commercial activity envisaged by its charter documents provided such activity is not prohibited by Russian corporate law or other legislation, subject to licensing where applicable (see below). A JSC may contract, undertake legal obligations, acquire property, and sue and be sued in its own name. A joint stock company may be either ‘open’ (OJSC or OAO in Russian), meaning publicly held, or ‘closed’ (CJSC or ZAO in Russian), meaning privately held. Both forms may issue common or preferred shares and debentures. Both forms are subject to statutory reporting

requirements and regulatory restrictions, but the requirements for public disclosure are less rigorous for CJSCs.

No provision in the organising documents can be made to prohibit a JSC shareholder from selling its shares. The shareholders of a CJSC, however, have non-waivable pre-emptive purchase rights.

For an OJSC, the statutory minimum authorised capital is 100,000 roubles (approximately US\$4,000), and 10,000 roubles (approximately US\$400) for a CJSC.

Different classes of shares are permitted; dividends and voting rights are equal for each share in a class. Shares in a joint stock company are considered ‘securities’ under Russian securities law and must be registered with the Federal Service for Financial Markets at the time of issuance.

The board of directors (supervisory council) of a JSC is responsible for the overall management of the company’s activities. The powers of the directors normally include all powers not specifically delegated to the general meeting of shareholders or other management bodies. However, these powers may be specifically limited by the company’s charter document or other applicable laws. Directors have broad fiduciary duties, and may be held individually or jointly liable for damages to the company resulting from their misconduct.

Accounting records must be kept in roubles and according to Russian accounting rules (records may also be kept in parallel according to any other accounting standards, eg, IFRS).

Dividends may be paid quarterly, semi-annually, or annually. The decision to pay dividends is made at the shareholders’ meeting, but the amount of dividends is recommended by the board of directors. Dividends are determined based on the financial statements prepared under Russian accounting and reporting standards.

Limited liability companies

Limited liability companies are also a popular form of corporate organisation. They are often used by foreign companies to conduct wholly-owned businesses in Russia.

The minimum authorised capital for an LLC is 10,000 roubles (approximately US\$400).

The Limited Liability Company Law provides for many similar provisions to those in the Joint Stock Company Law.

A notable distinction between LLCs and JSCs is the division of the capital of an LLC into ‘participations’ or units that are not considered securities under the Russian securities law, unlike shares in a JSC, which are securities.

Unlike in a JSC, the sale of participations by a participant of an LLC can be restricted in the charter. Also, a participant may withdraw from an LLC at any time, requiring the LLC (or remaining participants) to provide it with a portion of the net assets of the company proportionate to its interest.

Limitations on the sale of participation interests or preferential purchase rights or on the approval process for a transfer of a participation may be included in the charter of an LLC.

Dividends and voting rights are determined by the participants in the charter, although some restrictions on voting rights exist in the Limited Liability Company Law. Shareholders of a joint stock company JSC (participants of a LLC) have the power to amend the company’s rules and by-laws, change its authorised capital, elect members of the board of directors, approve annual reports, and adopt decisions on reorganisation and liquidation.

In general, a shareholder’s or participant’s liability is limited to the extent of the capital it has invested in the company including any unpaid amounts. However, in the event of the bankruptcy

of a company, a parent organisation may be held liable by a company's creditors if the parent's actions caused the subsidiary to become insolvent.

The definition of 'parent' is quite broad and includes control not only by reference to ownership, but by contractual or other relationships that allow a person, including a parent, to determine the decisions of the company. Application of these provisions is uncertain, which, in practice, often leads to investments in Russia being made through an offshore special purpose vehicle.

No Russian entities can be considered as pass-through for tax purposes – they must pay Russian tax on income (24 per cent) from the sources in Russia, value-added tax (18 per cent) on Russian operations as well as a property tax (up to 2.2 per cent of the asset value), even if no operations are carried out.

US investors

10 What form of entities do US investors customarily use in your jurisdiction?

Foreign companies conducting Russian business operations increasingly view a wholly-owned Russian subsidiary as a relatively quick and easy way of expanding their local businesses. Usually an LLC is used as it is simpler to register and manage.

In certain cases when there is no intention to establish a local entity it is possible to conduct business directly from outside of Russia by creating a local representative office which is not regarded as a Russian legal entity.

There is no choice especially popular among US investors.

Organisational formalities

11 What are the organisational formalities of creating the above entities? What requirements does your jurisdiction impose on a foreign entity? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Registration of a legal entity takes at least three to five weeks, including one to two weeks following the submission of certain required documents to the registration (tax) authority. The tax authorities finalise the state and tax registration of a company and then forward the documents for registration with the social funds and Federal Service for State Statistics without the involvement of the company being registered.

When a foreign founder is involved, there is a need for a number of documents to be apostilled (or legalised), translated and notarised, which can mean that the period from commencing the process to its completion significantly exceeds this period.

The state fee for registration of an LLC or JSC is 2,000 roubles (approximately US\$80), plus some other small amounts. The professional fees for the entire process of collecting documents, preparing organisational documents and presenting the documents to the Russian registration authorities typically range from US\$6,000 to US\$7,500.

Rouble and foreign currency accounts can be opened after registration. Prior to registration an 'accumulative' account is opened to pay up the charter capital. Certain requirements established by the government and specific requirements that may be established by each bank must be met. For an LLC, 50 per cent of the charter capital must be paid prior to state registration and the balance must be paid within the period established by the foundation agreement (but not more than one year from the date of state registration). For a JSC, 50 per cent of the charter capital must be paid within three months after state registration and the balance within the period established by the founda-

tion agreement (but not more than one year from the date of state registration). Charter capital contributions can be made in monetary form or in kind. Debt may not be capitalised as a contribution to capital.

Generally, only one participant or shareholder is required. Under a special rule, if a sole participant or shareholder of a Russian company (LLC or CJSC) to be formed is itself a company owned by only one participant or shareholder, then the Russian company to be formed must have at least two participants or shareholders. A CJSC with over 50 shareholders must convert to an OJSC. An LLC with over 50 participants must convert to an OJSC or into a manufacturing cooperative.

Documentation

12 Does your jurisdiction or customs recognise a non-binding form of agreement? Is there a form of non-binding agreement before a contract? Is it customary to take the property off the market while negotiation of a contract is ongoing?

Non-binding agreements are usually structured as memorandums of understanding and letters of intent. They are not legally regulated and thus do not form an enforceable contract. They can gain legal effect only if they form a 'preliminary agreement' signed by both parties, describing all the main features of the planned transaction, including an obligation to sign a principal agreement in the stipulated term.

The property may be taken off the market during negotiations subject to payment of a retainer by the buyer. Usually it is a question to be resolved at the parties' own discretion.

Contract of sale

13 What are typical provisions in a contract of sale?

Land plot sale and purchase agreements are concluded in writing by means of preparing one document to be signed by the parties.

Land plot sale and purchase agreements must contain the essential conditions stipulated by Russian Federation legislation (an agreement not containing such conditions shall be deemed non-concluded), in particular, the price, and any data that allow for unambiguously identifying the land plot. Sale and purchase agreements must also comply with other requirements for the execution and contents of sale and purchase agreements stipulated by current Russian Federation law.

Russian legislation stipulates certain special requirements for agreements for the sale and purchase of a land plot; namely, the following conditions are invalid when incorporated into land plot sale and purchase agreements:

- establishment of the seller's right to buy out the land plot at the seller's discretion;
- establishment of rights restricting the further management of the land plot including those restricting mortgage, transfer of the land plot for lease or the conclusion of other land transactions; and
- establishment of rights restricting the seller's liability in cases when third parties claim rights to the land plot.

The interests of a land plot purchaser are further protected by the requirement, established by the Russian Federation Land Code, for the seller to provide the buyer with all available information on the encumbrances on the land plot and the restrictions on its use. Should the seller provide the buyer with patently false information on encumbrances on the land plot and restrictions

on its use, on the permit to construct thereon, or on the use of neighbouring land plots, that significantly affects the use and price of the land plot being proposed for sale, or other information that may affect the buyer's decision to purchase such land plot, the buyer may require that the purchase price be reduced or that the land plot sale and purchase agreement be terminated and damages inflicted on the buyer be paid. If the buyer wishes to conduct a more complex research it is usually being done at its own expense.

The amount of down payment is usually negotiated by the parties and it depends on the circumstances of a particular deal. As escrow services are still not widespread in Russia, the down payment is usually kept on the sellers' account, or alternatively letters of credit are used.

Environmental clean-up

- 14** Who takes responsibility for a future environmental clean-up? By representation with survival provisions? What are typical general covenants? What remedies do the seller and buyer have for breach?

Owing to a general paucity of legal practice regarding environmental damage, the inclusion of the covenants or representations regarding the environment is not yet widespread. A very general rule of the Civil Code indicating that the seller is liable for latent defects of the merchandise is understood to cover consequent environmental and other damage.

Leases

- 15** What are typical representations and covenants regarding leases? Do they cover brokerage agreements and do they survive closing? Are estoppel certificates customarily required and can estoppel certificates substitute for representations?

Usually the seller is required to indicate all lease agreements relating to the sold property in a separate document attached to the acquisition agreement. Russian legislation and business practice does not recognise estoppel certificates.

Leases and mortgages

- 16** Is a lease generally subordinate to a mortgage pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a mortgage upon foreclosure? Do lenders typically require subordination and non-disturbance agreements?

As a rule a subsequent mortgagee's rights are subordinate to those of the prior mortgagee. No special subordination concept exists in Russian legislation relating to leases. Subordination and non-disturbance agreements are not enforceable.

Delivery of security deposits

- 17** What steps are taken to ensure delivery of security deposits to a buyer? How common is it to get a security deposit under a lease? Do leases customarily have periodic rent resets?

Security deposits are widespread. Usually they are transferred in cash to the lessor's account. Rent resets are rare in lease agreements in Russia.

Due diligence

- 18** What is the typical method of a title search and is it customary to order searches? Is there something akin to title insurance and opinion letters? Does your jurisdiction provide statutory priority for recorded instruments?

Due diligence is usually performed by both legal and non-legal counsel (accountants, management and marketing consultants). Legal due diligence is performed through a search in public registers as well as through a review of documents represented by the seller. As a result a due diligence report is prepared. Opinion letters are not widespread because regulations of lawyer liability for professional misconduct or mistake is quite uncertain.

Reviews

- 19** Is it customary to arrange an engineering or an environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Whether to arrange an engineering or an environmental review is a business issue. No customary practice exists in relation to these processes.

Review of leases

- 20** Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Leases are usually reviewed both from the business and legal sides. The following issues are usually covered by a legal review: validity of lease, term of lease, possibility for a pre-term dissolution or termination, possibility to increase rental payments, rights to sublet, etc.

Other agreements

- 21** What other agreements does a lawyer customarily review?

Usually any and all agreements related to the real estate are reviewed. The scope of analysis can be narrowed by the concept of materiality.

Closing

- 22** What does a lawyer customarily prepare for a closing?

As no customary practice exists the list may vary from time to time. In any case special attention is paid to registration and authorities of the counterparty, title to the property and provisions required by law (form of contract, registration, price etc.)

FINANCING

Form of lien

- 23** What is the method of creating and perfecting liens?

Liens are created through a written agreement between the creditor and the debtor (mortgage) or through a court decision (arrest).

Legal requirements

- 24** What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

No particular consequences are provided by Russian law in this regard. Written form of any lien documents is required. Mort-

Update and trends

An attractive opportunity for both foreign investors and Russian companies owning plants, factory buildings and other real estate acquired in the course of privatisation is provided in the Introductory Law Land Code of the Russian Federation. These proprietors may buy out the land beneath it on favourable (below-market) conditions and therefore cut costs on rental payments and increase the capitalisation of their properties. The new amendments to the Law provide that if such persons acquire the land plots before 1 January 2010, their price is set to within 20 per cent of cadastral value of the plot located in cities with a population over 3 million people, and within 2.5 per cent of cadastral value of the plot located anywhere else (cadastral value is at least five to six

times below market price). Before the price is determined by the subject of federation, the highest price for such kind of area is used.

To evade fraudulent actions, the Law has determined the procedure of withdrawal of speculative profits. Thus, in cities with populations over 3 million, local authorities may prohibit construction and reconstruction of buildings situated on a privatised land plot (excluding the buildings and constructions that do not comply with town-planning regulations). The prohibition may be cancelled at the owners request followed by payment of the special fee set within 80 per cent of cadastral value of the plot.

gages are registered with the Unified State Register of Titles to Real Estate and Transactions. The fee for the registration is quite modest (2,000 roubles to 7,500 roubles; approximately US\$80 to US\$300)

Interest

- 25** Is interest charged on a spread over LIBOR, Euribor or relevant equivalent? What rate of interest is usurious in your jurisdiction and what are the consequences if a loan exceeds the usury rate?

LIBOR and Euribor are broadly used in large international finance transactions. Small and mid-sized deals usually refer to a fixed amount of interest. No usurious rates are provided for in Russian legislation.

Enforcement

- 26** How are remedies enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding?

Enforcement is always carried out through a judicial procedure. Only in the event a special agreement is signed between the debtor and the creditor at foreclosure can it be performed through a public order. A bailiff service at the Ministry of Justice is addressed after a judgment or a notary act is received.

Protection of collateral

- 27** What actions can a lender take to protect its collateral until it has possession of the property?

Special protective actions in connection with the collateral are not provided by Russian law. The mortgaged property can be left either with the mortgagee or with the mortgagor.

Recourse

- 28** Do the security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy filing?

Recourse for a secured lender is limited to the collateral. If the amount of the money received after the sale of collateral is not enough to cover the debt, then recourse to other assets can be made. Bankruptcy proceedings bring a significant change in the order of recourse.

Cash management systems

- 29** Is it typical to require a cash management system and do lenders typically take reserves?

No particular requirements of a cash management system are common in Russia.

Credit enhancements

- 30** What other types of credit enhancements are common? What about forms of guarantee?

Guarantees of different kinds (payment guarantees, banking guarantees) are the most widespread methods of credit enhancement. Letters of credit are successfully used for large-scale transactions. Holdbacks and carve-back guarantees are not commonly used.

Covenants

- 31** What are commonly used covenants in loan documents? What is the difference depending on asset classes?

Russian law makes no provision for the concepts referred to, but business practice successfully employs concepts from English law, which are usually acceptable under Russian legislation.

Financial covenants

- 32** What are typical financial covenants?

Russian law makes no provision for the concepts referred to, but business practice successfully employs concepts from English law, which are usually acceptable under Russian legislation.

Bankruptcy

- 33** Describe the bankruptcy system in your jurisdiction.

Relations connected with the insolvency of legal entities in the Russian Federation are governed by the new Federal Law On Insolvency (Bankruptcy) No. 127-O3, which became effective on 3 December 2002.

Insolvency is understood as the debtor's inability, as recognised by a state arbitration court, to satisfy creditors' claims regarding monetary obligations fully, to fulfil its obligations to make mandatory debt payments, or both.

A legal entity is recognised as being unable to satisfy creditors' monetary claims or fulfil its mandatory payment obliga-

tions if its outstanding liabilities have not been met within three months of their due dates.

The consideration of bankruptcy cases falls within the jurisdiction of state arbitration courts of the Russian Federation.

Courts initiate bankruptcy proceedings against legal entities in cases when the sum of creditors' claims exceeds 100,000 roubles (approximately US\$4,000).

The right to initiate a bankruptcy suit for recognising a debtor as bankrupt is vested in the debtor, the creditor, and authorised persons, for example, tax authorities.

When particular signs of a debtor's insolvency become apparent, the debtor's authorised body must bring a bankruptcy suit to a court for the commencement of bankruptcy proceedings aimed at adjudicating the debtor a bankrupt within one month from the date when the relevant circumstances occurred.

In cases of fraudulent and deliberate bankruptcy, the law provides for measures of civil and criminal responsibility of founders and employees of legal entities.

During consideration of bankruptcy suits, the following main bankruptcy procedures apply to debtors that are legal entities:

- oversight;
- financial recovery;
- external management;
- bankruptcy proceedings;
- settlement agreement.

Following the submission of an application for commencing bankruptcy proceedings and the acceptance of such by a state arbitration court, the court places the debtor under surveillance for the time required for preparing for hearing the bankruptcy case (which usually takes several months).

Lockboxes

- 34 What are the requirements of creation and perfection? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Lockbox services are not yet offered by Russian banks.

Single purpose entity (SPE)

- 35 Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy filing, has the concept been upheld?

No requirements for an SPE exist in Russia. The concept of an independent director exists, but in the context of corporate governance and not real estate or loan issues.