LATHAM & WATKINS LLP

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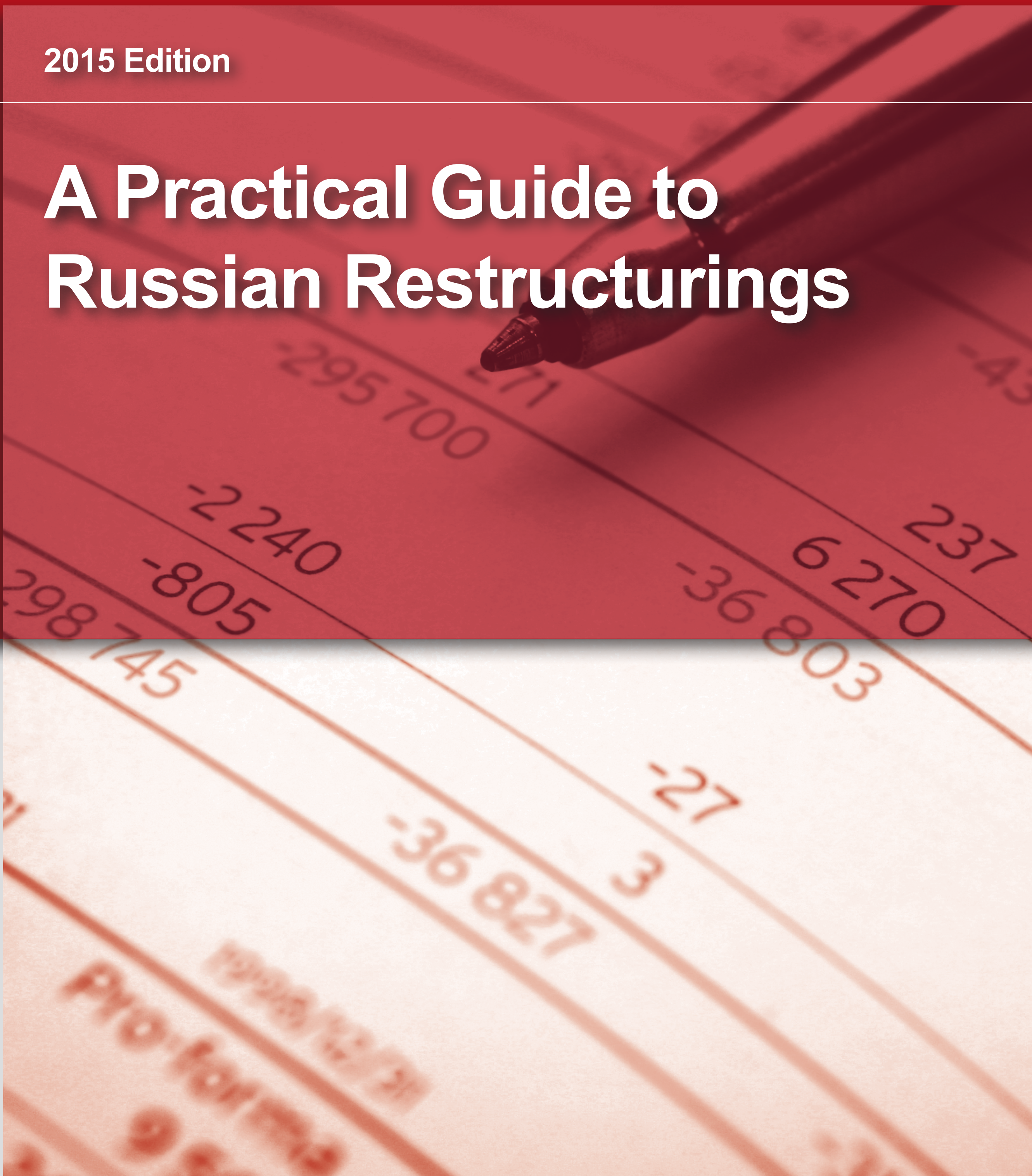
A Practical Guide to Russian Restructurings



A PRACTICAL GUIDE TO RUSSIAN RESTRUCTURINGS

Introduction

Restructurings are likely to be a major topic in the Russian Federation during 2015 and beyond. From a legal perspective, the legislation pertaining to restructurings and insolvencies has benefited from a number of positive developments in recent years. In particular, the amendments which were introduced into the Civil Code[1] at the end of 2013[2] (the **Civil Code Amendments**) and the Insolvency Law[3] at the end of December 2014[4] represent a significant step forward. Nevertheless, the Russian legislation still lacks many of the tools and features required to facilitate consensual restructurings, particularly from the perspective of the unsecured creditor.

In this Practical Guide, we highlight the legal and practical issues that a lender is likely to encounter in a Russian restructuring context and attempt to outline possible solutions. While no "one size fits all" approach exists to replace the careful analysis required for each unique restructuring, certain issues are likely to arise and apply more than others.

Accordingly, this Practical Guide provides a general overview of the position of a commercial lender in circumstances in which its Russian borrower is in financial distress or insolvency.

Contents of This Practical Guide

Sections I, II and III set out the applicable legal background, focusing on the implications of the Russian insolvency regime on the lender's bargaining power to achieve a favorable, consensual restructuring. These sections also focus on certain foreign law measures which, if available, can enhance the lender's position.

Section IV analyses six potential restructuring scenarios. In respect of each scenario, we briefly discuss, among other things, the ability of a lender to:

- Cancel or set off the obligations of a borrower in exchange for shares in the borrower
- Provide additional financing and strengthen its position as a creditor in an event of default
- Obtain control over the borrower

A more detailed table of contents follows this Introduction. Readers familiar with the relevant legal framework may wish to go directly to **Section IV** (*Analysis of Six Hypothetical Restructuring Scenarios*).

In a non-consensual restructuring scenario, the lender may consider the advantages and disadvantages of enforcing its security. For these purposes, in **Section V** (*Enforcement Regimes for Various Types of Assets*), we outline the various steps and considerations lenders should take into account when enforcing different types of security.

Assumptions

For the purposes of this Practical Guide we have assumed that the borrower (or debtor) is a Russian commercial legal entity (that is not a bank or a financial institution) and the lender's claim against the borrower is in respect of a loan provided by it. Accordingly, although these issues may be important in practice, we do not analyze the importance of recognition of foreign insolvency proceedings and do not comment on other claims or actions that may potentially be available to the lender (such as in respect of fraud or other wrong-doing).

We assume that the governing law clause of the relevant finance documentation follows customary market practice — Russian law for rouble bond documents and, generally, English law for loan agreements and other debt instruments. In respect of security interests, we assume that the security is validly given under Russian law (or such other law as the context may indicate), the secured property is not subject to any other security interests and the secured claim is not subject to any subordination or inter-creditor arrangement.

In certain places, we refer to the secured lender or the secured creditor. In practice, the security may have been granted in favor of a security agent or trustee (as opposed to the lender itself). This approach, although widely used in the Russian market in the context of syndicated financing transactions, gives rise to certain additional considerations which are beyond the scope of this Practical Guide.

Disclaimer

The information contained in this Practical Guide should not be construed as legal advice. If you require any further analysis or explanation of the subject matter, or if you wish to discuss the subject further, please contact any of the Latham & Watkins attorneys listed at the back of this Practical Guide.

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A. Position of Creditors prior to Initiating Russian Insolvency Proceedings

1. Unsecured Creditors

Before insolvency proceedings have been initiated against a Russian debtor under the Insolvency Law, a lender as an unsecured creditor enjoys a number of contractual rights under the relevant transaction documents relating to the loan. The most important of these rights is typically the right to accelerate the loan. In other words, the lender can demand, upon the occurrence of one or more pre-agreed events of default, immediate repayment of the loan in full and exercise the right to receive default interest on any unpaid sums.

Furthermore, following an event of default, loan agreements and other debt instruments may include provisions designed to protect the creditor — such as a right to receive additional and more detailed financial, operational and other information about the borrower than would otherwise be available to the creditor in the ordinary course.

Moreover, an unsecured lender may request from the borrower, or another member of the borrower's group (for example, as part of a waiver negotiation process with the borrower), security over property (thus rendering the lender a secured creditor) or quasi-security, such as a guarantee.

In addition, a lender has a number of statutory rights (subject to the governing law of the relevant debt or security instrument) and remedies in respect of a debtor. The most important of these is the right to sue the debtor for breach under the contract and request payment of damages. If the lender obtains a judgment, but the debtor fails to pay, then the lender may seek a writ of execution from a court permitting the debtor's assets to be attached and, potentially, foreclosed upon.

Notwithstanding the availability of various statutory remedies granted to lenders under Russian law in the course of enforcing writs of execution, exercising such remedies in practice may be time-consuming, costly and ultimately unsuccessful for the creditor.

2. Secured Creditors

In addition to benefitting from rights broadly similar to those of unsecured lenders, secured lenders also benefit from the contractual and statutory rights associated with their security.

(a) Security Interest: Pledges

The primary security interest which Russian law recognizes is a pledge. The Civil Code distinguishes between a pledge of movable assets and a "mortgage" (*i.e.* a pledge of immovable assets, such as real property, buildings and other fixtures). In this Practical Guide, except where the context requires otherwise, all references to a "pledge," "pledged assets" and "pledger/pledgee" include references to a "mortgage," "mortgaged assets" and "mortgagor/mortgagee," respectively.

Under Russian law, a pledge only exists if (and for as long as) the pledge secures a valid obligation. A pledge does not transfer legal title, even if the pledged asset is itself physically transferred into the possession of the pledgee. However, a pledge provides the pledgee with certain priority rights over the pledged asset and certain other rights. In particular, following the Civil Code Amendments, a pledge of shares (or participatory interests) may also confer on the pledgee the right to vote or receive dividends, or both.

The most common forms of pledges are:

- Pledge over movable property (such as shares, equipment and other movable property[5])
- Mortgage over immovables

In addition to contractual rights under the relevant security agreement, the holder of a Russian pledge has the rights and remedies set out in the Civil Code[6] or, as the case may be, the Mortgage Law,[7] the Enforcement Law[8] and other applicable legislation.

Depending on the type of pledge, Russian law sets out certain notarization and registration requirements with which a pledge agreement needs to comply for such pledge to be enforceable. In particular, the provisions of the Mortgage Law necessitate registering any mortgage with the Russian Unified State Register of Rights to Real Estate and Transactions therewith (EGRP) to be enforceable. For a pledge of intellectual property rights to be enforceable, in most cases the underlying pledge agreement must be registered with the Russian Federal Service on Intellectual Property, Patents and Trademarks (Rospatent).

The Civil Code Amendments also introduced the regime of voluntary registration with regard to movable property, pursuant to which a pledge of movable property (other than shares, participatory interests and bank accounts) may be recorded with the register, which the notaries maintain in electronic form (the Register of Movables). Whereas the new system is voluntary, in practice, the registration plays a vital role in protecting the pledgee's rights. In particular, the law provides that the pledge of a movable asset is only enforceable against third parties if such pledge is registered in the Register of Movables. In addition, if there are multiple pledgees in relation to one pledged asset, the priority of the pledgees' claims is determined in accordance with the chronological order such pledges were registered in the Register of Movables. Registering pledges of movable assets with the Register of Movables is, therefore, particularly important in the case of the security provider's bankruptcy, as any pledged asset would form part of the property subject to division among differently ranked creditors. In the absence of registration, the pledgee would not be able to ascertain its rights against third-party creditors.

For a detailed overview of security enforcement regimes, notarization and registration requirements with respect to pledges over various types of assets, see Section V (Enforcement Regimes for Various Types of Assets).

(b) Quasi-security: Guarantees
Russian law also recognizes certain quasi-security instruments (guarantees) which provide additional support to lenders.

From the lenders' perspective, the main advantage of guarantees is that this type of quasi-security allows the lender to transfer the risks associated with the borrower's non-performance to more financially sound entities. However, the lender should bear in mind that receiving either a bank guarantee or a suretyship would not render its claims against the debtor a "secured claim" in a potential insolvency scenario. Thus, the lender's claims could not enjoy preferential treatment against the debtor or the guarantor in the event that the lender's claims are not fully satisfied by the guarantee providers.

(c) In-court Enforcement
A secured creditor may enforce the security in the event of the debtor's failure to duly perform the secured obligations. Unless the finance documents provide for out-of-court enforcement, the secured creditor needs to file a claim to court to enforce security.

If the court sanctions enforcement of security, the relevant security will be enforced through one of the permitted enforcement procedures specified by the underlying security document (or a separate agreement reached between the secured creditor and the security provider). Court enforcement generally may be performed by way of public auction, acquisition by the pledgee (retention) or private sale without an auction. However, the applicable permitted methods of court enforcement may, in practice, depend on the type of the secured asset, as further described in Section V (Enforcement Regimes for Various Types of Assets). A secured creditor is privileged — its claims may be satisfied out of the value of the secured asset received as a result of enforcement ahead of the claims of unsecured creditors (or, if the secured creditor retains the secured asset, the claims of such secured creditor will be reduced by an amount equal to the value of the secured asset).

(d) Out-of-Court Enforcement
Out-of-court security enforcement[9] may be provided for in the security agreement or in a separate agreement entered into between the secured creditor and the security provider.

Such an agreement must establish the starting price to be used in the course of enforcement (or set out a method for determining such starting price) and describe the relevant permitted enforcement methods. Out-of-court enforcement is generally allowed by way of one of such pre-agreed permitted enforcement methods, which may include public or private auction, or retention (for example, by way of transfer of title to a secured property to a secured creditor) or private sale without an auction (the latter is not possible in the case of mortgage enforcement).

Russian law sets out detailed procedures for out-of-court enforcement by way of notary endorsement. Enforcement by the pledgee without a notary is also possible (this, however, is not the case in respect of a mortgage). However, due to lack of detailed regulation, such enforcement may be not feasible in practice.

In order to be eligible for out-of-court enforcement by way of notary endorsement, the underlying pledge agreement must be notarized. After the lender has decided to enforce the security, the notary sends to the security provider (and the debtor) a notice of enforcement. If following the expiry of the statutory grace period (which is 14 calendar days), the security provider (or the debtor) does not discharge the secured obligations, the notary is entitled to execute the endorsement. After that the relevant pledge agreement may be submitted to bailiffs for enforcement.

(e) Limitations on Enforcement
Russian law sets out a number of limitations on enforcement.

The security provider and the debtor are at all times entitled to stay out-of-court enforcement by discharging the secured obligations. The security provider is also entitled to file a petition to a court asking the court to stay out-of-court enforcement and arrange a public sale of the secured asset. The court would satisfy such a claim if the claim establishes that the enforcement violates the rights of the security provider or that there is a material risk of such violation.

In addition, enforcement is not permitted if the breach of the secured obligations is immaterial and the amount of the creditor's claim would, therefore, be disproportionate to the value of the secured assets. In particular, with regard to a payment default, the breach is presumed to be immaterial (and the amount of the creditor's claim is presumed disproportionate to the value of the secured assets), if both the following conditions are met:

- The amount of the defaulted payment is less than five percent of the value of the secured assets.
- The payment default has continued for less than three months.

In respect of a default on periodic payments (such as payment of interest), levy of execution is allowed in case of systematic non-payments, such as three or more overdue payments in respect of any 12-month period preceding the enforcement (even if each such overdue payment is immaterial). In practice, to avoid any discussion about materiality, a secured creditor would accelerate the entire debt outstanding under the relevant debt instrument.

In addition, a Russian court may order a stay of enforcement (of up to one year) following a pledgor's petition in certain cases and may generally prohibit acceleration, if the borrower is undergoing insolvency proceedings.

(f) Government Approvals for Enforcement
At any stage of enforcement, any change of control that arises as a result of enforcement may also require approval from or notification to relevant government regulators.

Normally, in an enforcement scenario in which the secured creditor or a third party has the right to acquire the debtor, the acquirer of direct (and in some cases indirect) control over a Russian company must make the appropriate filings with the Federal Antimonopoly Service (the FAS) in advance of the acquisition in accordance with the Competition Protection Law.[10]

If the debtor is a "strategic enterprise" or "natural monopoly" or is engaged in certain heavily regulated industries, (such as banking, aviation or natural resources) special governmental approvals may be required or limitations may apply, particularly if the acquirer is a non-Russian person.

Obtaining such approvals can be a lengthy process and needs to be taken into account when structuring the security package.

B. Position of Creditors in Russian Insolvency Proceedings

1. Initiating Russian Insolvency Proceedings

Insolvency proceedings may be initiated by:

- The debtor's creditor(s)
- State authorities
- The debtor itself (upon decision of its governing bodies)

As a general rule, a debtor is deemed to be insolvent (and insolvency proceedings may be initiated in respect of such debtor) if its debts are more than three months overdue, and the overdue amount is greater than RUB100,000 as confirmed by a court decision which has entered into legal effect. According to the recent amendments to the Insolvency Law, the threshold of RUB100,000 will increase up to RUB300,000 after 1 July 2015.

In certain cases, the debtor is obliged to file for its bankruptcy. For instance, when the debtor is unable to pay its debts for more than one month or has insufficient assets to satisfy its liabilities. If the debtor initiates insolvency proceedings, it is obliged to send prior notice thereof to all its creditors and forward them a copy of its application for insolvency. According to rules effective as of 1 July 2015, such notification will be made by way of publishing the application with the relevant data in a publicly accessible register (the Russian Unified Federal Register of Bankruptcy Information).

A liquidator may also initiate insolvency proceedings in the course of the debtor's voluntary liquidation, if a liquidated debtor shows any of the "signs" of bankruptcy specified above.

2. Rights of Creditors in the Course of Insolvency

Rights of creditors vary depending on the stage of insolvency proceedings.

Upon initiation of the insolvency proceedings, creditors may only file their claims with the relevant arbitrazh court that is considering the insolvency case within the timeframe specified at law, in order to ensure that the creditors are included into the insolvency list of creditors who vote at the creditors' meetings. At such meetings the creditors approve nominees for positions of insolvency administrators and determine the course of insolvency proceedings, such as whether or not to authorize the amicable settlement. In order to include a creditor into the insolvency list, the court needs to verify the substance of the creditor's filed claim. The court also needs to determine the ranking of the claims. The voting rights of such creditor at the creditors' meeting depend on the amount of such creditor's main claim.

Typically, after the insolvency proceedings commence, all debts are deemed to be automatically due and payable, any debt recovery by creditors is suspended (other than recovery relating to employment, health or moral damage claims, as well as vindication claims) and any set-off violating statutory priority of claims is prohibited. Enforcement of security may only be achieved in certain cases, in particular, when enforcement does not prevent restoration of solvency, whereas out-of-court enforcement of security is prohibited.

In addition, after certain (more advanced) insolvency stages (described below) commence, creditors' rights are further diminished. In particular, after financial restructuring is established, contractual penalties stop accruing on debt and the only default interest payable is the refinancing rate which the Central Bank of Russia (the CBR) determines. After external management commences, the CBR refinancing rate also applies instead of the margin set out in the loan agreement.

3. Types of Russian Insolvency Proceedings

Russian insolvency legislation provides for four major stages of insolvency proceedings, some mandatory and some optional. Russian law also recognizes amicable settlements as a possible outcome of basically any stage of insolvency proceedings.

Insolvency/winding-up procedure typically has several stages (some of which are optional):

- Supervision (*nablyudenie*) of up to seven months
- Financial restructuring (*finansovoe ozdorovlenie*) of up to two years
- External management (*vneshnee upravlenie*) of up to two years (whereas financial restructuring and external management combined may not exceed two years)
- Bankruptcy management (*konkursnoe proizvodstvo*) of up to one year

The court supervises all proceedings and assigns an important role to the creditors' committee and the court-appointed manager.

Generally, insolvency proceedings start with the supervision stage (*nablyudenie*). During the supervision, a temporary manager (*vremenniy upravlyaushiy*) which the creditors or the debtor itself (in case of voluntary bankruptcy application) propose and the court appoints carries out the following:

- Determines the overall amount of outstanding indebtedness
- Analyzes the debtor's financial standing
- Receives the creditors' claims
- Arranges the first meeting at which the creditors decide on the next stage(s) of bankruptcy

During this stage, although the debtor's management does not have the right to authorize certain key actions (such as a merger, restructuring, liquidation, payment of dividends, borrowing of additional debt and others) and is generally under the supervision of the temporary manager, the management remains in charge of the debtor's day-to-day operations.

Upon commencement of the supervision stage, all of the debtor's obligations become due and payable. However, such obligations, save for current liabilities, may only be settled within the insolvency proceedings. All set-off is prohibited, except for strictly regulated netting in respect of derivatives conducted in compliance with the Russian legislation. The temporary manager is responsible for ensuring that information regarding the commencement of the insolvency proceedings is published in an official newspaper. Such information is also publically available on the internet. All creditors must present their claims to the debtor within 30 days of the commencement of the insolvency proceedings. However, as a matter of Russian law, the creditors of a Russian guarantor have the right to enter into that guarantor's insolvency proceedings at any time if the principal obligations become due and remain unpaid.

Generally, the duration of the supervision stage is subject to a maximum term of seven months.

Following completion of the supervision stage, the court may, if the creditors so elect, decide to proceed with a financial restructuring (*finansovoe ozdorovlenie*) of the debtor. During a financial restructuring, although the management of the debtor has day-to-day control of the debtor's operations, the administrative manager (*administrativniy upravlyaushiy*) has ultimate control. The aim of this stage is to restore the debtor's solvency and arrange for the debtor to repay the outstanding debt in accordance with the agreed repayment schedule. A financial restructuring may last up to two years and is rarely used in practice as it usually requires a third party to provide security to ensure the satisfaction of the creditors' claims.

The parties may attempt to restore the debtor's solvency during the external management (*vneshnee upravlenie*) phase that may be introduced by the court for up to two years. Upon commencement of external management the external manager (*vneshniy upravlyaushiy*) obtains all management powers over the debtor (and accordingly the existing management loses all its power). External management leads to a moratorium on discharging debtor's obligations, other than current payments, such as taxes and wages. The external manager may use various instruments to restore the debtor's solvency, including disposal of assets, termination of contracts, issuance of shares, replacement of assets, etc.

At any time during the insolvency proceedings, the court may:

- Determine that the solvency of the debtor cannot be restored
- Rule that the debtor is bankrupt
- Commence the bankruptcy management stage (*konkursnoe proizvodstvo*)

The bankruptcy manager (*konkursniy upravlyaushiy*), who replaces the existing management of the debtor, identifies all the debtor's creditors, locates the debtor's assets, disposes of such assets to the creditors and discharges obligations the debtor owes to its creditors in accordance with the priority of creditors' claims (see paragraph 6 (Priority of Claims in Insolvency) below). After all of the debtor's assets have been disposed of to its creditors in accordance with the priority, the debtor is officially liquidated and ceases to exist.

The types and timeframes of Russian insolvency proceedings are summarized in the table at the end of this Section.

4. Terminating Russian Insolvency Proceedings

Under the Insolvency Law grounds for terminating insolvency procedure include:

- Restoration of the debtor's solvency
- Conclusion of an amicable settlement (as described in paragraph 5 (*Amicable settlements*) below)
- Waiver of creditors' right
- Satisfaction of all creditors' claims

In addition, pursuant to the amendments to the Insolvency Law, if the court discovers that the debtor itself or any creditor, being an "interested party" (as described in Section III.C.2(a) (*Definition of Interested Party*)), applied for insolvency in bad faith seeking unjustified benefits, while at the same time being aware of the debtor's solvency, the court will be entitled to terminate the insolvency procedure, provided that the debtor in fact is solvent and the creditor's interests are not impaired as a result.

5. Amicable Settlements and UK Scheme of Arrangement

Russian law also recognizes amicable settlements (*mirovoe soglashenie*) as a possible outcome of insolvency proceedings. At any stage of the insolvency proceedings described above and if the debtor does not have wages arrears, the debtor (usually represented by the relevant managers appointed by the creditors) and the creditors are entitled to conclude an amicable settlement (agreement) which sets out the terms and procedures for the repayment of the outstanding indebtedness. Amicable settlements bind all creditors included into the creditors' list. All security existing prior to the date on which an amicable settlement is reached is retained by default.

Such a settlement agreement must be approved by the majority of creditors and all the secured creditors and signed by the debtor. For such a settlement agreement to take effect, it must be sanctioned by the Russian court. The court will not authorize an amicable settlement, unless the unsecured claims of first- and second-priority creditors are satisfied.

In essence, an amicable settlement under Russian law shares certain characteristics with (and could be regarded as a prototype of) a UK scheme of arrangement.

However, an amicable settlement — unlike a UK scheme which is a statutory procedure that does not bear the stigma associated with insolvency — is an insolvency procedure that could trigger various defaults (including cross-defaults) under existing documentation. Therefore, an amicable settlement cannot be implemented in Russia before the commencement of insolvency proceedings. In addition, its terms are subject to the general deficiencies and restrictions of the Russian insolvency regime discussed in further detail in Section I.B.4(a) - (c) (*Limitations on Protection of the Debtor's Going-concern Value*).

In the UK, this procedure is primarily used to implement any step in the restructuring process which requires unanimity from the relevant class of creditors. When deciding whether or not to authorize a scheme, an English court must, amongst other things, be satisfied that the scheme will likely be upheld by the courts in the relevant local jurisdiction and expert evidence is normally relied on to give the court comfort. The English courts play a limited role, which is confined to two separate hearings:

- Regarding class composition
- Sanctioning the scheme

Therefore, a UK scheme of arrangement provides more flexibility than a Russian "amicable settlement" and may be viewed more favorably in a potential restructuring scenario. A UK scheme of arrangement could serve as a useful alternative to the insolvency proceedings under Russian law. The UK scheme of arrangement is not an insolvency procedure and may be implemented at any stage of the restructuring process.

In essence, this mechanism represents a UK statutory compromise or arrangement between a company and its creditors. A scheme must be approved by the majority in number and 75 percent in value of all creditors in each class present and voting. Thus, the arrangement can be used to "cram down" non-consenting creditors. Applying a UK scheme of arrangement offers a number of benefits and, in particular, allows the relevant parties to:

- Implement debt-for-equity swaps
- Keep the company solvent and preserve the company's value
- Use "shareholder cram-down" mechanics
- "Cram-in" minority dissenting or non-participating creditors, for example into exchanging old debt for new debt or equity

To use an English scheme, a company must have "sufficient connection" with England. The English court is the judge of whether a company has such sufficient connection. This threshold has been gradually relaxed and case law now suggests that English law governed finance documents are enough to establish sufficient connection. Given the widespread use of such documents in the Russian market there is high probability that an English scheme could be used in potential restructuring scenarios similar to the ones described in Section IV (*Analysis of Six Hypothetical Restructuring Scenarios*) of this Practical Guide (if the loan agreement is governed by English law). Furthermore, we are aware of at least one Russian court judgment which recognized an English scheme.

Once the relevant majority of creditors passes the scheme, it is submitted for approval to the English court. The latter will be able to exercise discretion and will only sanction the scheme if the creditors can show that there are no procedural irregularities and if the scheme is deemed fair and reasonable. The scheme is then filed with the Companies House in the UK, at which point it will become effective and, thereby, binding on all creditors, even if they voted against it or did not have notice of it.

The principal steps and the associated timeline for a UK scheme of arrangement are as follows:

- Creditors' lock-up to agreed restructuring term sheet
- Prepare scheme documentation
- Company applies for hearing date to convene the first creditors' meeting and issues a "practice statement letter"
- "Class Hearing:" the first court hearing during which the court gives directions to convene scheme creditor meetings, and (typically) gives guidance on correct determination of creditor classes
- Circulate a notice of scheme meetings and explanatory statement to all known affected creditors
- "Creditors' Meeting:" meetings during which the scheme proposals are put to the creditors (and/or members) for voting (resolutions are passed by 75 percent in value and 50 percent in number of scheme creditors present and voting)
- "Sanction/Fairness Hearing:" the second court hearing during which the court reviews the findings at scheme meetings and if satisfied, sanctions the scheme
- The scheme becomes legally effective

6. Priority of Claims in Insolvency

If a borrower has entered into insolvency proceedings under the Insolvency Law, the creditors' claims must be paid in accordance with the order of priority set out in the Insolvency Law. No low-ranking claim can be paid until all high-ranking claims have been paid in full. Claims of equal priority are generally paid on a *pro-rata* basis. In case of insolvency, the Insolvency Law requires each creditor to assert its claims so that these are included into the so-called ranking list, which determines the amount due from the debtor to such creditor. Creditors' claims which are not recorded in the ranking list or which have been determined to be preferential or suspicious transactions (as described below), are generally the last claims to be satisfied and may be considered fourth-priority claims.

Claims which have arisen after the insolvency proceedings commenced (including certain mandatory claims, such as taxes, salaries or fees) have super-priority in relation to any unsecured claims and need not be included into the ranking list. However, the amount of such claims may be subject to certain limitations.

(a) Pre-petition Unsecured Claims
Unsecured creditors' claims which became due prior to the commencement of the insolvency proceedings and have been included into such ranking list are discharged as follows:

- First-priority claims include those arising from the debtor's liabilities to individuals for harm to life or health, or for moral harm.
- Second-priority claims arise out of the debtor's obligation to pay wages, salary or other amounts payable under employment agreements in the ordinary course of business, or to pay fees or royalties to authors of intellectual property.
- Other claims included into the ranking list constitute third-priority claims.

Despite being third-priority claims, in practice, mandatory payments enjoy a certain privileged status since they are satisfied prior to all other pre-petition unsecured claims of third-priority pursuant to a certain order. Post-petition mandatory payments have a super-priority and are settled as current claims.

(b) Current Claims
Current claims are claims which arise after insolvency proceedings are initiated against the debtor. Current claims are satisfied "outside the statutory order of priority" applicable to pre-petition unsecured claims, meaning that current claims actually have super-priority in relation to pre-petition unsecured claims.

(c) Secured Claims
In an insolvency context, claims secured by collateral over the debtor's assets are generally settled ahead of all other claims out of the proceeds from the sale of such collateral. Given that the collateral shall be sold at auction, the parties generally agree on the starting price for auction-sale purposes in the security document. The recent amendments to the Insolvency Law, however, entitle the secured creditor to determine the starting price on its own. If an arbitration manager or other creditors in the insolvency procedure are not comfortable with the ascertained starting price, they may apply to court and petition the court to establish such price instead.

The Insolvency Law basically allows for 70-80 percent of the proceeds of sale, depending on the nature of the claim, to be allocated to the relevant secured creditors. 15-20 percent of such proceeds are typically allocated to first- and second-priority creditors with the remaining 10-15 percent being used to settle current claims. Depending on a number of issues (including the nature of the creditors and type of security they hold), the allocated percentage may vary in respect of certain entities (for example, in case of a bankruptcy of a shared construction cooperatives, individual investors would typically get a higher percentage of assets than institutional investors, such as banks).

(d) Uncertainty as to Priority Conflicts
In certain respects, the Insolvency Law is not entirely clear on the rules for determining priority among competing claims. In particular, notwithstanding their complexity, the Russian priority rules do not adequately address priority conflicts (in particular, those relating to pledge priority as contemplated by the Civil Code Amendments, but not yet tested in courts) which can arise in transactions, particularly in sophisticated debt financings.

7. Limitations on Enforcing Claims

In Russia, a lender's ability to pursue and enforce its claim against an insolvent debtor is limited in certain circumstances, as described below.

(a) Suspending Creditors' Rights (Moratorium)
Immediately following the initiation of insolvency proceedings in the form of supervision (*nablyudenie*),[11] the Insolvency Law imposes a stay on all creditors' claims, other than current claims and certain other claims. Under the stay, creditors may only make demands against the debtor for repayment, enforce their security or otherwise

exercise their rights against the debtor in relation to the claim to the extent and in the manner permitted under the Insolvency Law. The stay lasts until the end of the relevant phase of the insolvency proceedings, but a similar stay comes into effect at the beginning of each subsequent phase. The term moratorium is stricter under the Insolvency Law and is used to designate suspension of both creditors' claims and current claims. The moratorium is imposed after the initiation of insolvency proceedings in the form of external management (vneshnee upravlenie).

(b) Clawback Risks
A variety of the debtor's transactions are subject to invalidation in the course of insolvency.

In case of insolvency proceedings against a borrower, a pledgor or a guarantor (the relevant person), the following transactions entered into by such relevant person within a certain period of time prior to or after the commencement of the insolvency proceedings may be challenged:

- Suspicious transactions – transactions without adequate consideration and on disadvantageous terms or transactions willfully aimed at causing harm to creditors generally
- Preferential transactions – transactions that lead or may lead to preferential treatment of a particular creditor, including transactions aimed at changing the order of statutory priority of claims

The arbitration manager may submit an application for invalidation on its own initiative or at the request of the creditors' meeting or committee.

The recent amendments to the Insolvency Law also allow a creditor to challenge a transaction without involving the arbitration manager, if such creditor's exposure exceeds 10 percent of the total indebtedness of all creditors featured in the ranking list. This novelty may well simplify the challenging procedure as it allows avoiding interim procedures like convocation of creditors' meetings necessary for challenging transactions.

(c) Limitations on Enforcing Security
Even if enforcing security in the course of insolvency proceedings would otherwise be permitted, a court will not grant leave to a secured creditor to enforce its security if the debtor shows that enforcement will render impossible the debtor's return to solvency. This is the case even if the relevant security agreement contemplates out-of-court enforcement. The Insolvency Law does not set any standards or give any guidance as to the scope of this provision. However, from the perspective of a secured creditor, the practical effect of this limitation on enforcement appears to be that the more critical to the debtor's business the secured assets are (for example, key plant, machinery or inventory), the greater the risk that the security cannot be enforced.

8. Limitations on Protecting Debtor's Going-concern Value

A major stated policy of the Insolvency Law is to give the debtor the best possible opportunity to return to solvency. However, the Insolvency Law offers inadequate post-petition protection for the going-concern value of the debtor's business and for creditors willing to lend new money to the debtor, as the debtor attempts financial restructuring. The Insolvency Law does not allow consensual standstill or reorganization, and the restructuring of the debtor's debt may be subject to clawback risks. Indeed, subject to certain exceptions, it is fair to say that these characteristics of the Insolvency Law at times create a bias toward liquidation. There are a number of other limitations on protection of the debtor's going-concern value.

(a) Lack of Stay on Trade Creditors Terminating Contracts
Unlike the insolvency regimes in the US and some European jurisdictions, the Insolvency Law does not prevent suppliers, customers and other trade creditors from terminating contracts on the sole grounds that the debtor has entered into insolvency. As a result, when the debtor enters into insolvency proceedings, the debtor may no longer be able to rely on business-critical counterparties and relationships. Depending on the nature of the business and its underlying assets, this factor can make a financial or operational turnaround much more difficult, or even impossible, for the debtor.

(b) Insufficient Protection for New Money Creditors
The Insolvency Law also does not sufficiently protect parties who would be willing to lend new money to the debtor after insolvency proceedings have commenced. The Insolvency Law does not provide that the new money

creditors' claims will have priority over pre-existing secured claims. In the course of insolvency proceedings, any subordination arrangements against the debtor violating the statutory priority of claims will be void. Furthermore, in practice, any new claims would be subject to clawback risks. This is all true even though such a loan would normally be a current claim with super-priority over pre-petition unsecured claims (as discussed previously). In international markets, new money lenders are often willing to lend only if they will be fully secured by way of a first-priority security interest over the debtor's valuable and marketable property. However, a debtor in insolvency is likely to have little or no property which is free of other creditors' security interests, and the Insolvency Law does not provide that the new money creditor's claims will have priority over pre-existing secured claims.

(c) Absence of Shareholder Cram-down

The Insolvency Law provides no mechanism that enables creditors to directly coerce a debtor or its shareholders into a reorganization process whereby, in exchange for extinguishing the indebtedness, the creditors would either receive (i) the existing shares in the debtor from the existing shareholders or (ii) new shares in the debtor. Any such arrangement would require the consent of the shareholders and the court, as well as, in some cases, the arbitration manager. See Section II.B.1 (*Shareholder Consent Required*) for details.

Given that the Insolvency Law does not give creditors the ability to coerce shareholders to accept such an arrangement, the shareholders can "hold out" (that is, refrain from cooperating or providing the relevant consent) in insolvency proceedings, making their lack of consent an obstacle for creditors to recover value. If the business is generally sound but experiences a short-term liquidity problem, shareholders may use this tactic in the hope that the passage of time will allow the business to recover. If the business is unsalvageable, the shares are worth little or nothing, and shareholders therefore stand to lose nothing by threatening to let the debtor fall into liquidation.

Accordingly, the absence of a shareholder "cram-down" mechanism in a Russian insolvency context creates a significant risk that, if no consensual restructuring is agreed, the creditors will lose control of the process and experience a significant delay in recovery and/or a material reduction of the amount recoverable. This risk is, however, partially mitigated by the appointment of external or arbitration managers (depending on the stage of the insolvency proceedings) who control or replace the management bodies of the insolvent entity. These arbitration managers can sanction certain types of transactions, and prohibit certain types of transactions, such as set-off, suspicious or preferential transactions, which may be challenged, as described in Section 7(b) (*Clawback Risks*) above.

(d) Long Horizon for Exit from Insolvency or Liquidation

Russian insolvency proceedings can be protracted, increasing the risk of non-recovery and the cost of the process for a creditor. If a debtor ultimately goes into liquidation, it could conceivably remain in insolvency proceedings for up to four years in total; spending up to seven months in supervision, up to two years (combined) in financial restructuring and external administration, and up to one year in liquidation. The length of the proceedings can exacerbate the other risks and limitations inherent in the Russian insolvency regime (such as stay or moratorium on creditors' claims), further shifting the balance of power to debtors, as described in Section 7(a) (Suspension of Creditors' Rights (Moratorium)) above.

9. Insolvency Regime Limitations and Implications for the Lender

Initiating insolvency proceedings is a risky strategy. Instead of improving the likelihood, speed and amount of recovery for commercial creditors, insolvency proceedings may well have the effect of eroding the value of the assets out of which the creditors expect to be paid. Furthermore, as discussed above, shareholders may have little to lose from exploiting their consent rights to delay or otherwise obstruct any recovery by creditors.

In practice, given the combination of these factors, one might reasonably expect that, unlike in the US, the UK or certain other European countries, where some form of clear-cut "cram-down" or other statutory or practical alternative to shareholder consent is available, the time and funds costs associated with fulfilling consent rights would be significantly higher and less efficient in Russia.

10. Controlling Persons' Liability

Pursuant to the Insolvency Law, if a debtor's insolvency was caused by the debtor's controlling person's acts or omissions, then this person may (on the initiative of insolvency manager filed within the statutory prescription period) be held liable for the debtor's obligations, if the debtor's property is not sufficient to satisfy all creditors' claims.

The notion of a "controlling person" designates a person which is or was entitled (no more than two years before the filing of the insolvency application) to give mandatory instructions to the debtor or otherwise determine the debtor's course of actions (including, by way of coercing the debtor's management). In particular, controlling persons may include the debtor's 50 percent-majority shareholder/participant, debtor's chief executive officer or the debtor's representatives.

The Insolvency Law presumes that a debtor became insolvent due to acts or omissions of such debtor's controlling person if either of the following apply:

- The losses suffered by creditors are the result of the conclusion or approval by such controlling person of a transaction entered into for the benefit of such controlling person.
- There are no accounting or other reporting documents with regard to such debtor or the relevant documents do not contain sufficient information or distort the available information about the debtor's property, as a result of which insolvency proceedings or bankruptcy management become substantially more complicated.

However, a controlling person may rebut such presumption if it proves either of the following:

- There was no fault of such controlling person in the debtor's insolvency.
- Such controlling person was acting in good faith and reasonably in the debtor's best interests.

A controlling person's liability may be reduced to the amount of creditor claims for which such controlling person is liable. If several controlling persons are found liable, these controlling persons bear joint and several liability.

Moreover, the debtor's controlling persons, as well as its participants and managing bodies, may be subject to administrative or criminal liability in the form of fines, disqualification or imprisonment if they take or omit to take certain actions relating to insolvency proceedings or during any of stages thereof (such as concealing assets, defrauding creditors, satisfying creditors' claims in violation of statutory order, causing bankruptcy or failing to file for bankruptcy, if filing is mandatory).

II. STRUCTURAL ISSUES IN A REFINANCING AND RESTRUCTURING CONTEXT

This section discusses the implications of certain Russian law issues on the mechanics of the restructuring itself, whether through amendment of the debt instruments, provision of equity financing or a debt-for-equity swap.

A. Restructuring Debt Instruments

A borrower will normally seek one or a combination of concessions from its lenders, depending mainly on its current and projected cash flows. These concessions may include, for example:

- Temporary relief from making payments
- A postponement of the repayment date or other changes to the payment schedule
- Repayment of part of the indebtedness
- Waiver of breaches of covenant

- Release from certain financial or other covenants
- Standstill provisions (that is, an agreement by the creditors not to exercise certain rights or remedies)
- Provision of additional financing

Agreeing to such concessions requires the borrower to negotiate with all necessary parties in relation to each debt instrument. To implement the concessions, the parties and their legal advisers must enter into appropriate agreements, and the borrower must file and publish any documents required by applicable securities or other laws.[12]

1. Negotiating and Implementing Modifications to Debt Instruments

Negotiating and implementing concessions in a debt restructuring is much easier if both:

- There is a small number of creditors whose consent is required.
- The existing debt instrument can be feasibly amended under applicable law.

When indebtedness arises under a loan agreement (including an intra-group one), the restructuring thereof is usually relatively straightforward. In such cases, the borrower normally must only deal with a small number of lenders or with an agent empowered to negotiate on behalf of the lenders, so long as a sufficient majority of lenders approve the terms of the restructuring (the relevant majority required will depend on the provisions of the relevant debt instrument and the nature of the amendments required to implement the restructuring). Once the concessions are negotiated, the parties can implement them simply by entering into appropriate agreements.

If there are many creditors, as is often the case with bonds, negotiations may involve a large group of investors with disparate (and sometimes conflicting) interests. Accordingly, bond documentation will generally provide that a trustee will represent those investors, or a core group of investors will form and act through a committee. This smaller number of parties at the table can streamline the negotiation process. In any case, the borrower must nevertheless ensure that a sufficient majority of bondholders approve any concessions.

Some debt instruments cannot be amended without significant difficulty, or at all. Unlike European-style high-yield bonds, which normally can be amended as described above, US-style bonds are more difficult to amend. Some amendments cannot be made as a matter of law, if the bonds are subject to the US Trust Indenture Act of 1939, as amended. To restructure such US bonds, issuers use other mechanisms, such as purchases of the outstanding bonds through market buybacks or cash tender offers, or through exchange offers for new bonds containing the revised provisions.

As discussed in more detail below, rouble bonds issued in Russia can only be amended in certain circumstances. This may limit the parties'ability to restructure rouble bond indebtedness. The parties may, however, be able to "work-around" the issues and achieve an acceptable result, but the process is nevertheless likely to be difficult and to entail significant risks.

2. Amending Terms of Rouble Bonds

Amending the terms of a rouble bond is possible under certain circumstances. The terms are set out in the issuer's decision on issuance and in the bond's prospectus, both of which must be registered with the CBR. The amendment procedure also involves registering with the CBR, subject to certain exceptions.

The parties' ability to amend a Russian securities prospectus was introduced into the Securities Law[13] at the end of 2012. If three-quarters of the bondholders provide their consent pursuant to the procedure set out in the federal law, the offering decision relating to the bonds may be amended. In accordance with Federal Law No. 210-FZ dated 23 July 2013 (the majority of the law's provisions take effect as of 1 October 2016), the bondholders' consent may be obtained through a joint representative of the bondholders, who must be an experienced participant of the securities market (such as a broker) with over three years of relevant experience.

The introduction of these mechanisms represents a significant step foward in the context of consensual bond restructurings. However, the relevant rules are vague and should be detailed further with respect to the various types of bonds.

3. Limitations on Buybacks of Rouble Bonds

The Securities Law and the applicable regulations on rouble bonds permit an issuer to conduct a buyback of its bonds (if and to the extent provided in the bond documents) and set out a mechanism for conducting such buybacks. In practice, the requirements associated with such a buyback are similar to tender offer requirements.

To implement a buyback under these regulations, the issuer will require cash to pay the purchase price and may require third-party financing to obtain such cash — not always an easy task in practice.

The buyback itself is, of course, subject to acceptance by the relevant bondholders and, if the bondholders decline the offer, they will retain their bonds on the original terms. To incentivize bondholders to sell, issuers usually set the offer price at a premium to the trading price. Also the issuer commonly sets a threshold for the minimum (or maximum) number of bonds it will repurchase. The issuer may have an existing contractual right to repurchase the bonds on the terms of a call option set out in the bond documents, but "callable" rouble bonds remain relatively rare.

4. Limitations on Exchange of Old Rouble Bonds for New Rouble Bonds

A possible alternative to a cash buyback is an exchange offer — the issue of a new rouble bond, on re-negotiated terms, in exchange for the existing one. The exchange offer is subject to the same tender offer rules as a buyback for cash. In addition, the issuer must prepare, publish and register with the CBR the relevant documents for the new bonds. In practice, this process can be time-consuming.

Given that the issuer is in financial distress, investors accepting new bonds should seek to minimize the risk of other creditors challenging the validity of such new bonds on the grounds that the new bonds constitute a preferential transfer to one class of creditors at the expense of other classes. This risk is most relevant in circumstances in which the issuer is insolvent or the issue of new bonds would render the issuer insolvent. The risk could potentially also arise if the value of the old bonds could be construed as being lower than that of the new bonds (such as if a payment default is outstanding in respect of the existing bonds) and bondholders could therefore argue they received insufficient value in exchange. As mentioned in Section I.B.7(b) (*Clawback Risks*) above, under the Insolvency Law, preferential transfers are generally subject to invalidation if they are carried out a year prior to the initiation of insolvency proceedings against the issuer.

B. Debt-for-Equity Swaps and Equity Financing

Restructurings frequently involve one or more creditors obtaining an equity stake in the debtor: either as part of an exchange of shares for forgiveness of some or all of the debt; or in connection with new money being invested into the debtor. In a debt-for-equity swap, debt forgiveness may be in exchange either for existing shares of the debtor or for newly issued shares. Whilst an equity financing normally contemplates a subscription for new shares. In a Russian context, each of these methods gives rise to a number of issues to be considered and addressed.

1. Shareholder Consent Required

A debt-for-equity swap of either kind described above generally requires some form of consent from the debtor's shareholders. As discussed in Section I.B.8(c) (*Absence of Shareholder Cram-down)*, a subscription for new shares requires the approval of the debtor's shareholders, either prior to or during the insolvency proceedings. Moreover, even in bankruptcy, a controlling shareholder cannot be compelled to give up its existing shares in the debtor (except in very limited circumstances, such as if the shares are subject to a security agreement that a secured creditor is enforcing).

If, however, the lender has a pledge over a controlling interest in the debtor's shares or in the shares of the debtor's controlling shareholder, the creditor may be able to implement a coercive debt-for-equity exchange by enforcing that security upon an event of default. This may be especially effective in the (not uncommon) case of a pledge over a controlling interest in the shares of an offshore holding company that, in turn, controls the Russian debtor in circumstances in which the creditor has the right to appropriate the shares under the security documents (a self-help remedy discussed in Section III.B (*Right of Appropriation) below*). Indeed, in practice, the mere threat of such enforcement may be sufficient to persuade the debtor and its controlling shareholder to agree to a consensual debt-for-equity exchange on favorable terms (from the perspective of the creditor).

2. Consensual Debt-for-Equity Swaps

Under Russian law, the purchase price for new shares in a company cannot generally be paid by way of forgiveness of indebtedness, including by way of set-off. However, in certain limited cases, set-off is allowed. In particular, the shareholders may unanimously agree that the purchase price for the subscription of new shares can be paid by way of set-off. Likewise, the purchase price for new shares under a closed subscription (among the existing shareholders, for example) may be paid by way of set-off in accordance with the decision on allotting such new shares.

The benefit of this debt-for-equity swap option is that the creditors may exercise control over the borrower, or, at the very least, participate in the borrower's decision-making processes. However, a consensual debt-for-equity arrangement requires a number of corporate actions and may, therefore, take several months to be effected.

In a Russian joint stock company, a debt-for-equity swap may only be implemented by way of issuing additional shares under closed subscription. Such a subscription process involves a number of stages, including convocation of the general meeting of shareholders, registration of the additional share issue, record of shares with the registrar, placement of shares and registration of a report with the authorities upon completion of the placement. Any decisions allowing debt-for-equity swaps are subject to a 75 percent approval by the shareholders.

In a Russian limited liability company, a debt-for-equity swap requires additional participation share contribution (unless restricted by the charter) and involves a number of stages, including convocation of the general meeting of participants and registration of changes in the Russian Unified State Register of Legal Entities (EGRUL). Decisions allowing debt-for-equity swaps are subject to 100 percent approval by the participants.

Therefore, the scope for conducting consensual debt-for-equity arrangements is very limited under Russian law. The applicable new statutory provisions have not been extensively tested in courts. In essence, the procedure implies set-off by the creditor of its claims in exchange for equity in the debtor or its group of companies. Given that a borrower may not be coerced into performing a debt-for-equity swap, secured creditors usually opt for enforcement over pledged shares/interest in a controlling shareholder at the offshore level, which is usually more time-efficient.

The general practice is, therefore, that if the parties want the economics of the transaction to involve an exchange of shares or transfer of the debtor's obligation to a more solvent group company in return for forgiveness of the loan to the debtor, the transaction will be structured such that the lender pays the subscription price and the debtor then repays the indebtedness. This transaction requires the lender to provide cash up front and thus take additional borrower risk. Some of the non-payment risk may be mitigated by using an escrow structure pursuant to which the cash is paid into an escrow account with an independent third party (which the debtor cannot access) and then immediately repaid to the lender. But if the debtor becomes insolvent, the repayment is subject to avoidance as a preferential transfer to a creditor at the expense of others.

As an alternative, a debt-for-equity swap can be structured such that the debtor's controlling shareholder agrees to transfer to the lender some or all of the debtor's shares, in exchange for the lender's forgiveness of some or all of the debtor's indebtedness.

3. Regulatory Approvals Required

An acquisition of shares in a Russian debtor may require a number of governmental notifications or approvals, the most common being FAS approval in accordance with the Competition Protection Law, as described in Section I.A.2(f) (*Government Approvals for Enforcement*).

III. STRUCTURAL ISSUES IN A REFINANCING AND RESTRUCTURING CONTEXT AT THE LEVEL OF THE OFFSHORE SECURITY

Banks lending to Russian businesses often take security (often a pledge) over the shares of the Russian borrower's offshore parent company or controlling shareholder. If this structure is properly documented, such offshore security can give a lender significant advantages, either in the context of negotiating a restructuring or in protecting the lender's position in the borrower's insolvency. Russian insolvency proceedings (and any associated outcomes) typically would be recognized in offshore jurisdictions under international treaties recognizing bankruptcies or on a reciprocity basis. However, before enforcing such security, the lender should consider certain factors which may reduce these advantages (as discussed below).

A. Security Over Shares in Debtor's Offshore Parent Company

In practice, the security agreement will be governed by English law or by the laws of the jurisdiction where the parent company is incorporated. The Debenture and the Share Pledge (CypCo) as defined and described in Scenario IV.C (*Secured Creditors – Russian Lender(s), Foreign Lender(s), Multiple Security*) contained in Section IV (*Analysis of Six Hypothetical Restructuring Scenarios*) of this Practical Guide may serve as an example of such security agreements. In a Russian context, parent companies are frequently incorporated in Cyprus or in the British Virgin Islands (the BVI).[14] Generally, a creditor holding such security may sell the relevant shares upon the occurrence of an event of default and apply the sale proceeds to satisfy the secured obligations. In addition to providing collateral in respect of the loan, such a security interest may also be valuable to a creditor in other ways. In particular, the threat of enforcement is a useful negotiating tactic in a restructuring process which may, in practice, be more valuable than enforcement itself.

The utility of share security must be balanced against the fact that, as a practical matter, enforcement can be both costly and time-consuming, particularly in jurisdictions where out-of-court enforcement mechanisms are less developed than in Cyprus and the BVI. A borrower or other obligor may attempt to frustrate the enforcement or try to bring other claims in an effort to defeat or delay enforcement. Any resulting litigation may be protracted. Any delay increases the creditor's exposure to the risks of non-recovery and, in the worst cases, asset-stripping of the debtor or other malfeasance.[15]

B. Right of Appropriation

The right of appropriation under English or Cypriot law, and the laws of certain other EU countries,[16] may, in practice, be a very powerful tool. If a security agreement governed by the laws of such a jurisdiction provides for a right of appropriation, the secured creditor may take immediate ownership of the shares upon the occurrence of a specified event, such as an event of default. No notice or court order is required to exercise the right, and enforcement can often be accomplished in a matter of hours, if not minutes. This right provides a creditor with significant bargaining power.

A security agreement may also provide for a right of appropriation in respect of a BVI company's shares, so long as the security interest is governed by English law. This precedent came out of the ground-breaking BVI case, *Alfa Telecom Turkey Limited v Cukurova Finance International Limited*.

The appropriation right must be expressly provided for in a written agreement, and the scope of the right is subject to the terms of the relevant security document. So, as with any other contractual right or remedy, the creditor should ensure that the documentation sets out the specific rights and remedies sought by the creditor.

C. Offshore Security Enforcement as Means to Control a Russian Debtor

If the secured shares represent a controlling interest in the debtor's parent company, then successful appropriation or execution of the security may give the secured creditor effective control over the Russian debtor. This strategy can be very useful for several reasons, although the extent of such control depends significantly on whether the debtor's parent holds all of the debtor's voting shares, as discussed below.

Notably, however, following the recent amendments to the Competition Protection Law, the acquisition of a controlling stake in a foreign shareholder of a Russian entity may be subject to monopoly approvals.

1. Benefits of Control

If the parent company holds all the debtor's voting shares, an appropriation of such parent company allows the lender to control the Russian debtor and thereby overcome the absence of shareholder cram-down under the Insolvency Law. As discussed in Section I.B.8(c) (*Absence of Shareholder Cram-down*), in accordance with the Insolvency Law, the debtor's shareholders must consent to a number of significant transactions, including any issuance of shares or sale of substantial assets. Such control also allows the secured lender to replace the existing management if the management is not cooperative (or is deemed to be too loyal to the previous shareholder(s)) or otherwise fails to turn the debtor's business around.

In insolvency, such control is not unfettered. If the debtor is already in external management or financial restructuring (depending on the stage of the insolvency proceedings), the management's control over the business will still be subject to the broad powers granted to the external or arbitration manager (as applicable). In addition, any of the debtor's actions may require the consent of the arbitration manager, the arbitration court, the creditors' meeting or a combination thereof, as described in Section I.B.1 (*Types of Russian Insolvency Proceedings*) above.

2. Limitations Under Interested Party Transaction Rules

If, however, the parent company holds less than all of the debtor's voting shares, but holds 20 percent of the debtor's share capital or is otherwise considered to be an "interested party" in relation to the debtor under Russian law, the parent company will not be able to vote such shares in relation to transactions which involve the debtor and to which the parent company, or any of its affiliated or connected persons, is a party or beneficiary.

Thus, even if the secured creditor would otherwise obtain a controlling interest (20 percent of the share capital) in the debtor through enforcement of its security, the rules on interested party transactions would erode, and potentially eliminate, the creditor's ability to compel the debtor to take actions or enter into transactions necessary for the creditor to achieve its goals in a restructuring.

(a) Definition of Interested Party

The debtor's parent company would constitute an interested party[17] of the debtor under the Russian Companies Law (Russian Joint Stock Companies Law[18] or Russian Limited Liability Companies Law, as applicable)[19] if the parent, individually or together with its affiliated persons, holds more than 20 percent of the debtor's voting shares of the debtor.[20]

This definition may be expanded by the corporate charter of the relevant Russian company. If the debtor has entered insolvency proceedings, the Insolvency Law would impose an expanded definition of "interested party" and, in addition to the rules set out in the applicable Russian Companies Law, rules governing interested party transactions would apply.

(b) Requirement of Approval of Majority of Disinterested Shareholders

For a debtor to carry out an interested party transaction, it must obtain both:

- Under the applicable Russian Companies Law, and subject to certain exceptions — the approval of a majority of disinterested shareholders of the debtor[21]
- Under the Insolvency Law, if the debtor has entered into insolvency proceedings — the approval of the creditors' meeting. In external administration, the arbitration manager would carry out such transactions, so his or her approval would implicitly be required as well

In the context of a creditor with security in shares of a Russian debtor's parent company, these rules effectively mean that if the debtor has more than one shareholder, the creditor's acquisition of the parent's shares through security enforcement will not necessarily give the secured creditor effective control. Instead, the creditor will need to obtain the cooperation of the debtor's other shareholders to the extent that they are not interested parties in relation to the transaction which the creditor wants the debtor to carry out, or unless an exception applies.

(c) Exceptions to the Requirement

The Russian Companies Law does not require the approval of disinterested shareholders in relation to certain interested party transactions which may be relevant in a restructuring context, for example if:

- All of the debtor's shareholders are deemed to be interested in such transactions
- Such transactions arise from the debtor's repurchase, whether mandatory or not, of its issued shares
- Such transactions are entered into by way of realization of the shareholders' pre-emptive rights to purchase newly issued shares of the debtor
- Such transactions result from the merger of the debtor with another company[22]

Each of these circumstances may exist in relation to a proposed restructuring, and if so, they would relieve the secured creditor of the need to obtain such approval.

(d) Avoiding the Requirement Through Tender Offer and Minority Squeeze-out

Another avenue for the secured creditor in this scenario is to implement a "squeeze-out" of the minority shareholders, rendering the secured creditor (or the debtor's parent company) the sole shareholder of the debtor. This method requires using a two-step process under the tender offer rules set out in the Joint Stock Companies Law and related regulations. This method is only available if the debtor is a public joint stock company.

The first step is to carry out a tender offer by which the secured creditor directly or indirectly (through the debtor's parent company) acquires more than 95 percent of the debtor's voting shares or reaches 95 percent as a result of acquiring more than 10 percent of the debtor's voting shares via the regulated tender offer procedures. A person may make a tender offer if intending to acquire more than 30 percent of the company's voting shares (counting, for these purposes, voting shares already owned by such person and its affiliates). The offer price cannot be lower than the weighted average market price of the shares over the six-month period preceding the filing of the tender offer with the CBR. Once the tender offer is complete, and assuming the 95 percent threshold is met (including as a result of acquiring 10 percent of the debtor's voting shares), the person who acquired the shares in the tender offer may squeeze out the debtor's other shareholders by requiring them to sell their shares at the higher of the tender offer price and the highest price that person paid for its acquired shares.

The minority squeeze-out thus allows the secured creditor to eliminate other shareholders, and avoid the requirement for disinterested shareholder approval of interested party transactions. However, in practice, a successful squeeze-out requires that both:

- The secured creditor should fund or obtain financing for the tender offer
- Other shareholders accept the offer to sell a sufficient number of shares for the secured creditor to cross the 95 percent threshold (including, if such threshold is reached as a result of acquiring 10 percent of the debtor's voting shares)

D. Ability to Effect Migration of Center of Main Interests to a More Favorable Jurisdiction

Once the lender has acquired a controlling interest in the debtor's parent, the lender may be able to relocate the parent company's "center of main interests" to a jurisdiction such as England, where insolvency laws provide greater flexibility for achieving a restructuring than the laws of Russia or the parent's jurisdiction of incorporation.

E. Issues to Consider Before Enforcement

Even if the creditor perceives an urgent need to take immediate action to enforce its security in the parent company's shares, the creditor should consider whether execution or appropriation under the security could have unfavorable consequences, and weigh those consequences against the benefits. The lender should seek advice of legal advisers such as Latham & Watkins in respect of such issues, such as in the following examples.

1. Control

If the debtor has shareholders other than its parent company, the lender should beware that the rules on interested party transactions may limit or preclude the parent company's ability to vote its shares in the debtor on key transactions. See Section C.2 (Limitations under Interested Party Transaction Rules). In such case, enforcement may not give the lender sufficient control over the debtor.

As a due diligence matter, the lender should ask its legal advisers to review relevant documentation (such as the parent company's memorandum and articles of association) to ensure that enforcement will give the lender sufficient voting rights to control the parent, and in turn, to vote the shares of the Russian debtor. The lender or legal advisers should also check the relevant public registers of companies and security interests in those companies to ensure no other party has made any filings which could restrict the lender's rights over the shares, when acquired.

2. Intercreditor Arrangements

Russian legislation remains silent on a debtor's creditors' ability to enter into subordination or other ranking arrangements (although further amendments to the Civil Code, which currently remain under discussion, contemplate intercreditor agreements and ought to provide for such ranking).

Only subordinated loans provided to Russian banks for regulatory capital purposes are excepted. These loans generally rank below all senior creditors under Russian law.

In practice, intercreditor agreements are nevertheless entered into in connection with Russian acquisition and leveraged finance transactions. However, Russian law comes into play if the debtor has assets in Russia, irrespective of the law governing the intercreditor agreement. The Insolvency Law will govern the procedure of satisfying creditors from these assets and determine the enforceability of the contractual ranking of claims. Practice shows that Russian courts and bankruptcy administrators are reluctant to take into account the contractual ranking when allowing claims against the debtor's assets or when distributing proceeds to creditors. The courts and bankruptcy administrators primarily argue that the subordination is only a matter of contract and thus does not affect the statutory rules of liquidation of the borrower's assets — rules which also concern third-party creditors.

Therefore, the courts and administrators likely will only take into account the statutory subordination and ranking of claims, with the effect that the liquidation proceeds will be distributed in the order set out above. Furthermore, the junior creditors' share of the bankruptcy proceeds will correspond to their statutory ranking of claims.

3. Structural Subordination

If the lender retains the shares instead of satisfying its claim out of the proceeds from selling the shares, it has effectively:

- Converted its debt investment into an equity interest
- Traded its super-priority position as a secured creditor for a last-priority position as the debtor's shareholder

If the lender has no other security, enforcement would structurally subordinate a creditor's outstanding claims to those of other creditors, which could leave the lender significantly worse off.

4. Cross-defaults and Other Contractual Triggers

Enforcement of the security may trip contractual provisions which put the borrower, its parent company or its other co-obligors[23] in default or breach under obligations to other creditors. For example, the documentation for such an obligation may contain cross-default or cross-acceleration provisions, as well as provisions which deem the obligor in default upon the occurrence of any such enforcement (or certain other insolvency-related events). Similarly, the lender's acquisition of control over the borrower as a result of enforcement may breach restrictions on changes of control under the borrower's agreements — whether financial or commercial — with other counter-parties.

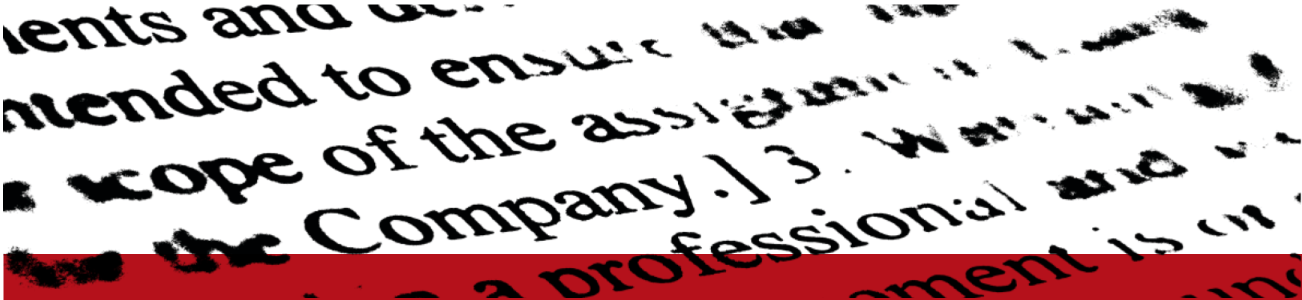
5. Regulatory Approvals

The change of control caused by enforcement may also require approval from or notification to relevant government regulators, as described in Section I.A.2(f) (Government Approvals for Enforcement).

6. Mandatory Tender Offers and Shareholder-related Restrictions

Under the rules relating to mandatory tender offers (MTOs), if — as a result of an enforcement of a share pledge relating to shares in a public joint stock company — the shareholding of any pledge holder (individually or together with its affiliates) exceeds the thresholds of 30, 50 or, if applicable, 75 percent of the total voting shares, such pledge holder shall make an MTO to the other shareholders. If a pledge holder (individually or together with its affiliates) becomes the owner of more than 95 percent of the shares in a public joint stock company, it must buy out the remaining shares at the request of the shareholders (MTO) or shall have the right to require that the shareholders sell their shares to it, provided that it has reached 95 percent as a result of acquiring more than 10 percent on the basis of a tender offer (minority squeeze-out). In an enforcement scenario, banks tend to find third-party purchasers to bear the related MTO obligations. However, if the pledge holder itself acquires the shares and consequently reaches the 30, 50 or, if applicable, 75 percent thresholds, it can avoid the MTO obligation if it sells such number of shares as is required to go below the relevant threshold no later than 35 days after such acquisition. A bank or a third-party purchaser making a tender offer shall first confirm such tender offer with the CBR.

Acquiring shares in a Russian limited liability company may also trigger certain additional steps, such as mandatory offer of such shares to the current shareholders for the purpose of exercising their rights of pre-emption.



IV. ANALYSIS OF SIX HYPOTHETICAL RESTRUCTURING SCENARIOS

This section provides a brief analysis of a creditor's legal position and options for restructuring the relevant debt in each of the following hypothetical restructuring scenarios:

Scenario A: Unsecured Creditor

Scenario B: Secured Creditor – Single Russian Lender

Scenario C: Secured Creditors – Russian Lender(s), Foreign Lender(s), Multiple Security

Scenario D: Debt-for-Equity Swap in Bankruptcy

Scenario E: Eurobond Issued by Offshore Parent and Guaranteed by Russian Operating Subsidiary

Scenario F: Non-convertible Interest-bearing Rouble Bond

A. Unsecured Creditor

Scenario: The borrower is a Russian legal person and the creditor is a Russian bank. The obligations are unsecured. The borrower is not able to pay principal and/or interest.

1. Assumptions

Loan Agreement: We assume that the obligations arise under a loan agreement.

2. Position Prior to Insolvency Proceedings

(a) Contractual Rights and Remedies
The lender benefits from the rights set out in the loan agreement. Using these, the lender has some leverage as it may threaten to declare an event of default and/or accelerate the loan (for example, on the basis of non-payment), potentially triggering cross-default or cross-acceleration provisions in the borrower's other credit facilities and, possibly, in the group as a whole. As part of the negotiation process, the lender may wish to request security for the outstanding loan. However, the borrower may not have any unencumbered assets over which to grant security or may be restricted from granting security as a result of negative pledge provisions set out in third-party loan documentation. The lender may also find securities a dangerous route if the debtor would go into bankruptcy, as such security may be invalidated as suspicious or privileged transactions, as described in in Section I.B.7(b) (Clawback Risks).

(b) Statutory Rights and Remedies
The lender may be able to sue on the debt and, if successful, seek a writ of execution allowing it to recover its claim out of borrower's assets. However, this option may be disadvantageous to an unsecured lender, as a writ of execution is useful only to the extent the borrower has cash or valuable unencumbered assets. In practice, filing a claim against the borrower may lead to insolvency proceedings (which, from the perspective of the unsecured lender, may be sub-optimal).

(c) Absence of Shareholder Cram-down
As Russian law does not contain any shareholder cram-down mechanics, a lender cannot acquire equity in borrower without the shareholders' consent, as described in Section I.B.8(c) (*Absence of Shareholder Cram-down*).

(d) Consensual Debt-for-Equity Swaps (D4E)
If a shareholder consents to D4E in principle, an exchange of existing shares for forgiveness of indebtedness may be an option. A subscription for new shares is more complex since a Russian company cannot accept debt forgiveness (other than debt forgiveness eligible for set-off) as consideration for newly issued shares. The lender should consider the risks and limitations associated with acquiring the equity, such as:

- Interested party transaction requirements (if borrower has more than one shareholder)
- Minority squeeze-out provisions in order to avoid requirement of disinterested shareholder approval
- Structural subordination

Each of these are discussed in Section III.E (Issues to Consider Before Enforcement).

(e) Additional Financing or Refinancing
The lender and the borrower have greater flexibility to agree upon the terms of a new financing. The lender will want security for the new financing, but a borrower in financial distress may have insufficient valuable and unencumbered assets. The lender may seek credit support in the form of guarantees from the borrower's subsidiaries, parent company and/or other affiliates.

(f) Taking Control of Debtor's Management
Control can be obtained either through acquiring a controlling stake in the borrower/its parent company (which gives rise to the same issues as D4E and also the necessity to obtain anti-monopoly approval) or, to a limited extent, in Russian insolvency proceedings. Otherwise, taking control of management requires the lender to acquire and exercise the powers of the borrower's shareholders using the mechanisms applicable to D4E. If the shareholders do not consent, the lender's options are limited to enforcing its security interests over the shares, if any. If D4E is implemented through enforcing the security, the lender should consider the implications of interested party transaction rules if the borrower has more than one shareholder.

3. Position During Insolvency Proceedings

(a) Priority of Claims
The claims of an unsecured lender do not rank high. If substantially all of the borrower's useful assets are

encumbered, as is often the case in a financial distress scenario, unsecured claims are likely to be fully impaired. Unsecured creditors would rank not only behind the claims of the secured lenders, but also behind other substantial claims (such as in respect of unpaid taxes or wages).

(b) Suspension of Rights and Remedies
An unsecured lender may exercise its rights and remedies only to extent permitted by the Insolvency Law (and subject, in certain cases, to stay or moratorium).

(c) Creditors' Meeting
An unsecured lender has the right to vote and attend the creditors' meeting, but must first register its claim so as to appear in the list of creditors.

(d) Clawback Risks
Any payments made during the six-month preference period are voidable, if such payments constitute a preferential transfer. Any payment the borrower makes during the one-year preference period may be voidable, if it constitutes a suspicious transaction, as described in in Section I.B.7(b) (*Clawback Risks*).

(e) Absence of Shareholder Cram-down
There is no shareholder cram-down mechanism in the Insolvency Law. A lender cannot acquire equity in borrower without the consent of the shareholders and also the relevant arbitration manager.

(f) Consensual Debt-for-Equity Swaps (D4E)
Subject to the considerations set out in Section IV.A.2(d) above, if the borrower is in insolvency proceedings, D4E is likely to require the approval of the creditors' meeting, the arbitration manager and possibly the court.

(g) Additional Financing or Refinancing
In a Russian insolvency, new debt-related claims cannot override existing security interests and the borrower is unlikely to have sufficient unencumbered assets. If the loan is for new equipment or the like, the lender may be able to take security over such new equipment. The lender can seek credit support (as in respect of a pre-petition financing). Any post-petition financing will be considered a "current claim" with super-priority over pre-petition unsecured claims, but will rank in one of the lowest categories of current claims. In practice, receiving security from an insolvent debtor or guarantees from its affiliates (in particular, its subsidiaries) may be subject to clawback risks and the risk that the transaction will be deemed to have been made at undervalue (and therefore, on preferential or suspicious terms).

(h) Taking Control of Debtor's Management
Subject to the considerations set out in Section IV.A.2(f) (*Taking Control of Management of Debtor*) above, in all phases of insolvency proceedings, certain transactions and other corporate actions by the borrower would require the consent of the arbitration manager and, in some cases, the court, which effectively reduces the control of the management and the shareholders. The borrower's management stays in place in all phases of insolvency proceedings, except for external administration (in which case the arbitration manager replaces the management, and the powers of shareholders' meeting as a management body of the debtor are limited to approvals of certain major transactions).

B. Secured Creditor — Single Russian Lender

Scenario: The borrower is a Russian legal person and the lender is a Russian bank. The obligations are secured by all of the following:

- A guarantee from the offshore (Cyprus or BVI) parent company of the borrower
- A pledge of shares in the parent (granted by a group company)
- A pledge of the assets of the borrower

The borrower is not able to pay principal or interest.

1. Assumptions

We assume that the borrower is the provider of the relevant secured property (and not an affiliate).

2. Position Prior to Insolvency Proceedings

(a) Generally

The position is similar to that described in Scenario A (*Unsecured Creditor*), plus the additional issues set out below.

(b) Contractual Rights and Remedies

The secured lender benefits from the rights set out in the security documents (see also equivalent provision in Scenario A (*Unsecured Creditor*)).

(c) Statutory Rights and Remedies

The rights of the secured lender under the Russian law security documents are also subject to the Civil Code and the Russian Notary Law relating to the enforcement of security. Prior to an insolvency process, the secured lender has a first-priority right to the enforcement proceeds. After the commencement of insolvency proceedings, as described in Section I.B (*Position of Creditors in Russian Insolvency Proceedings*) above, the priority of rights is determined in accordance with the Insolvency Law.

(d) Enforcement Rights

A lender may enforce security upon the occurrence of an event of default by obtaining a court order carried out by the Federal Bailiff Service (FBS)[24]. Or, if and to the extent provided in a written agreement with the borrower, the lender may enforce through out-of-court foreclosure through an auction or sale, and the secured lender may in some cases itself bid for or purchase the secured property.

(e) Debt-for-Equity Swaps

The position as to the absence of shareholder cram-down and consensual D4E is similar to the one described in Scenario A (*Unsecured Creditor*). However, the following should be considered: a secured lender may be able to acquire shares of a borrower or its parent company through enforcement of the lender's security interest in such shares, thereby giving the lender the ability to procure the shareholder consent. This strategy would be particularly effective in cases in which the lender has a foreign law security with a right to appropriate shares of borrower's offshore parent company. The lender should consider potential risks and issues involved in acquiring the equity, such as structural subordination and regulatory requirements, as discussed in Section III.E (*Issues to Consider Before Enforcement*).

(f) Additional Financing or Refinancing

The position is similar to the one described in Scenario A (*Unsecured Creditor*). However, with the following additional considerations: if the original security agreement grants a security interest covering future advances under the loan agreement, as well as the initial amount borrowed, any such future advance will benefit from the same security. The lender should ensure that both:

- The value of the secured property is at least equal to the sum of the debt outstanding under the loan and the amount of the future advance.
- The secured property is not subject to any competing security interests. Such checks may be conducted in respect of various types of security, such as participatory interests, shares and real estate (rights thereto). In respect of movable property such checks would be facilitated by the operation of the recently introduced pledge notification register.

(g) Taking Control of Debtor's Management

The position is similar to the one described in Scenario A (*Unsecured Creditor*), with the following additional considerations: a secured lender may also be able to take control over the borrower's management through enforcement of its security interest in shares of the borrower or the borrower's parent company.

3. Position During Insolvency Proceedings

(a) Priority of Claims
A secured lender has a priority right to the proceeds of sale of the secured property, although this extends only to the first 80 percent of such proceeds, the remainder of which is reserved for payment of certain "preferred claims" and the costs of the proceedings.

(b) Suspension of Rights and Remedies
A secured lender's rights to enforce are suspended during insolvency proceedings, and the lender may exercise its rights and remedies only to extent permitted by the Insolvency Law. During the financial restructuring (*finansovoe ozdorovlenie*) and external management (*vneshnee upravlenie*), the lenders may seek leave of court to enforce, but the court will permit enforcement only if the borrower fails to show that enforcement will render impossible the debtor's return to solvency.

(c) Creditors' Meeting
A secured lender may attend, but has very limited rights to vote. A secured lender may vote in financial restructuring and external management only if it has waived its right to enforce its security during the relevant phase.

(d) Clawback Risks
A payment made during the six-month preference period is voidable, if it constitutes a preferential transfer. Any payments made during the one-year period may be invalidated, if they constitute suspicious transactions.

(e) Debt-for-Equity Swaps
The position as to the absence of shareholder cram-down and consensual D4E is similar to the one described in Scenario A (*Unsecured Creditor*) and is subject to considerations in Section IV.B.2 (*Position Prior to Insolvency Proceedings*) above.

(f) Additional Financing or Refinancing
The position is similar to the one described in Scenario A (*Unsecured Creditor*) and is subject to considerations in Section IV.B.2 (*Position Prior to Insolvency Proceedings*) above.

(g) Taking Control of Debtor's Management
In addition to the considerations mentioned in Section IV.B.2 (*Position Prior to Insolvency Proceedings*) above, the secured lender may also take control of management of the debtor through Insolvency Mechanisms. Even though the borrower's management remains subject to the restrictions imposed by the Insolvency Law, the secured lender may have less influence over the insolvency proceedings due to the limitations on its voting rights at the creditors' meeting.

C. Secured Creditors — Russian Lender(s), Foreign Lender(s), Multiple Security

Scenario: Same facts as for Scenario B (Secured Creditor – Single Russian Lender) plus the following additional circumstances apply:

- Numerous Russian and foreign lenders are simultaneously creditors holding the same security jointly.
- The borrower is controlled by: (1) a Cyprus parent company (CypCo) for 99.9 percent and (2) a Russian individual (the Individual Shareholder) for the remaining 0.01 percent.
- The borrower is a direct shareholder of three Russian subsidiaries (the Russian Subsidiaries), namely: (1) a Russian LLC (LLC), (2) Russian LLC, which is a "strategic" entity (like the ones described in Section I.A.2(f) (*Government Approvals for Enforcement*)) (LLC (S)) and (3) a Russian Joint Stock Company (the JSC).

In addition, the loan is secured by multiple types of security, granted by various members of the borrower's group, including:

- English law guarantees from Russian Subsidiaries
- Cyprus law debenture provided by CypCo
- Cyprus law pledge of shares in CypCo

- Russian law pledges of shares (participatory interests) in the borrower (Share Pledge (Borrower)) and Russian Subsidiaries
- Russian law mortgages of various real estate assets (land plots, building and construction-in-progress) granted by the borrower under a single mortgage agreement (Mortgage) and of oil refinement facilities (Mortgage of Oil Refinement Facilities)
- Russian law pledge of bank account (Bank Account Pledge)
- Russian law pledge of movables (goods) (Pledge of Movables)
- Russian law pledge of lease receivables (Lease Receivables Pledge)
- Russian law pledge of IP rights (Pledge of IP)

1. Assumptions

We assume that:

- The lenders' claims arise under a secured loan.
- The loan is governed by English law.
- The creditors exercise their security rights jointly, cooperating with one another.

2. Position Prior to Insolvency Proceedings

General Considerations: The position is similar to that described in Scenario B (*Secured Creditor – Single Russian Lender*), subject to certain considerations.

(a) Cooperation

In particular, given that in this Scenario the creditors have common security, they would need to agree on the procedure for exercising their rights. Following the Civil Code Amendments, Russian law now provides for certain mechanics in this regard, such as establishing pledge seniority or appointing a pledge manager. However, how these new provisions will work in practice is not yet clear, and the secured creditors would still need to demonstrate a significant degree of cooperation.

(b) Contractual Rights and Remedies

Secured lenders benefit from the rights set out in the security documents (for a description of the equivalent provisions see Section IV.A.2(a) in Scenario A (*Unsecured Creditor*)).

(c) Statutory Rights and Remedies

Secured lenders enjoy the same rights as described in Section IV.B.2(c) in Scenario B (*Secured Creditor – Single Russian Lender*).

(d) Enforcement Rights

In broad terms, the secured lenders' position is the same as described in Section IV.B.2(d) in Scenario B (*Secured Creditor – Single Russian Lender*). Yet, the secured lenders should bear in mind the following considerations with respect to enforcement of pledges depending on the nature of the pledged assets. In particular:

- **Share Pledge (Borrower):** Secured lenders must consider beforehand whether foreign lenders acquiring equity interests would trigger regulatory approvals described in Section I.A.2(f) (*Government Approvals for Enforcement*). Depending on whether the borrower is an LLC or a JSC, the lender should also review considerations for Share Pledge (LLC) or Share Pledge (JSC), respectively.
- **Share Pledge (LLC):** Secured lenders must review the charter of the LLC beforehand for a possible restriction on pledge of equity in the LLC. In addition, lenders must ensure that the Individual Shareholder initially approved the pledge when it was created. Enforcement may require the borrower's cooperation for perfection of equity transfer in the EGRUL.
- **Share Pledge (LLC (S)):** In addition to the considerations laid out in relation to Share Pledge (LLC) above, the foreign secured lenders most likely would need to obtain consent from the FAS and from a special Commission of the Russian Government as LLC (S) is a so-called "strategic" entity as described in Section I.A.2(f) (*Government Approvals for Enforcement*). As a result, the enforcement proceedings will be lengthier.

- **Share Pledge (JSC):** The secured lenders must consider beforehand which documents should be provided to the registrar or the depository for the purposes of transferring the shares. If the JSC is a public company and any lender (individually or together with its affiliates) acquires 30, 50 or, if applicable, 75 percent of the total voting shares as a result of an enforcement, such lender may be required to start the MTO proceedings described in Section III.E.6 (*Mandatory tender offers and shareholder related restrictions*).
- **Mortgage:** Secured lenders should also bear in mind the necessity to register the mortgage agreement with the EGRP, as well as specific rules applicable to different types of real estate assets. For instance, the secured creditor may not be able to change the intended purpose of land use in the case of enforcement over a land plot. Enforcement of mortgage over a building also extends to the underlying land plot (or the land lease right), as under Russian law, buildings may not be mortgaged separately from the land plot on which they have been constructed. The same rules apply to the construction-in-progress.
- **Mortgage of Oil Refinement Facilities:** In addition to the considerations discussed in relation to the Mortgage above, secured lenders should also note the following. LLC (S) is a "strategic" entity by virtue of extracting oil on the subsoil plots of federal importance as its main business activity. Therefore, in the event that the mortgaged oil refinement facilities are deemed to be the main production facilities of LLC (S) and the value of such facilities exceeds 25 percent of its balance sheet assets as of the latest reporting date, enforcement of the mortgage would trigger the need to receive regulatory approvals described above in relation to enforcement of the share pledge in that company (see Section V (*Enforcement Regimes for Various Types of Assets*).
- **Bank Account Pledge:** Security may only be taken (and subsequent enforcement of such security may only be made) over a specific type of bank account that the pledger opens with the bank acting as pledgee or with a third-party account bank. The pledge may be created in respect of either (i) the balance of the pledge account from time to time or (ii) a fixed amount being the minimum balance of the pledge account. Given the relative novelty of this security instrument, the possibility of enforcement in practice should be considered beforehand.
- **Pledge of Movables:** Secured creditors should ensure that their rights are recorded in the Register of Movables. The Register was launched into operation in autumn of 2014.
- **Pledge of IP:** Secured creditors must take into account the need to register transfer of IP or rights thereto with Rospatent, as well as consider various restrictions that may apply to transferring IP rights under the law or licensing agreements.
- **Lease Receivables Pledge:** Enforcement is broadly similar to the rules applicable for Pledge of Movables described above. Whether Lease Receivables Pledge (as well as any other pledge of contractual rights) will be reflected in the Register of Movables remains unclear.

(e) Absence of Shareholder Cram-down

As discussed in more detail in Section IV.A.2(c) of Scenario A (*Unsecured Creditor*) above, the secured lenders in this scenario equally cannot enforce a shareholder cram-down on the borrower without its cooperation.

(f) UK Scheme of Arrangement

In the event that the lenders may prove in an English court that the borrower has a "sufficient connection" with England (which is likely to be the case due the execution of loan agreement and security documents under English law), the lenders may wish to consider using a UK Scheme of arrangement as a restructuring option without commencing the Russian insolvency proceedings. In practice, UK schemes have been used in Russia and both English and Russian courts acknowledged such schemes in a couple of cases. For a more detailed discussion, see Section I.B.5(*Amicable Settlements and UK Scheme of Arrangement*).

(g) Debt-for-Equity Swaps

The position of the lenders in this scenario is broadly the same as described in Sections IV.B.2(e) of Scenario B (*Secured Creditor – Single Russian Lender*) and in Section IV.A.2(d) of Scenario A (*Unsecured Creditor*). That said, given the potential acquisition of equity by foreign lenders (regardless of whether such acquisition will be with respect to CypCo (indirect) or the borrower (direct)), the foreign lenders may need to receive regulatory approvals described in Section I.A.2(f) (*Government Approvals for Enforcement*). Further, in case any lender becomes an "interested party" with the borrower in the meaning of the Russian Companies Law (e.g., by virtue of receiving more than 20 percent of equity) the lender's dealings with the borrower would depend on the other non-interested equity holders' approval. In the event that all of the lenders are deemed to be interested parties upon acquisition of a CypCo's 99.9 percent stake in the borrower, the lenders' dealings may become dependent on the approval of the Individual Shareholder holding the remaining 0.1 percent stake. Further considerations are discussed in Section III.C.2 (*Limitations under Interested Party Transaction Rules*).

(h) Additional Financing or Refinancing
The position of the lenders is similar to the one described in Section IV.B.2(f) of Scenario B (*Secured Creditor – Single Russian Lender*).

(i) Taking Control of the Borrower's Management
The position is similar to the one described in Section IV.B.2(g) of Scenario B (*Secured Creditor – Single Russian Lender*) (and, accordingly, Section IV.A.2(f) of Scenario A (*Unsecured Creditor*)). In the event that non-Russian secured lenders intend to take control over the borrower's management via enforcement of equity interests in the borrower or CypCo, the secured lenders should first consider the necessity to obtain regulatory approvals described in connection with the Share Pledge (*Borrower*) in this Scenario C.

(j) Additional Considerations
Additional restrictions may apply if the borrower is a strategic enterprise, natural monopoly or another type of entity which is subject to specific regulations. In broad terms, if enforcement of the security would result in a non-Russian person acquiring control over the borrower, such acquisition will require prior approval from the relevant Russian regulator (for description, see Section I.A.2(f) (*Government Approvals for Enforcement*)).

3. Position During Insolvency Proceedings:

The secured creditors' position in the insolvency proceedings in this scenario is the same as in Scenario B (*Secured Creditor – Single Russian Lender*) subject to the *General Considerations* and the specific considerations for the *Debt-for-Equity Swaps, Additional Financing or Refinancing* and *Taking Control of Borrower's Management* positions described in this Scenario B above.

D. Debt-for-Equity Swap in Bankruptcy

Scenario: The borrower is in the midst of the insolvency proceedings. A creditor wants to receive shares of the borrower in exchange for forgiveness of the debt.

Our analysis of D4Es is discussed previously in Scenario A (Unsecured Creditor), Scenario B (*Secured Creditor – Single Russian Lender*) and Scenario C (*Secured Creditors –*).

E. Eurobond Issued by Offshore Parent and Guaranteed by Russian Operating Subsidiary

Scenario: A foreign company (Cyprus or BVI) — whose obligations are secured by a guarantee/suretyship from the Russian operating company — defaults on Eurobonds.

1. Assumptions

(a) Identity of Parties
We assume that the foreign issuer of the Eurobonds (the issuer) has on-lent the proceeds of the issue to the Russian operating company (the borrower), as part of the typical structure for Russian companies' Eurobonds.

(b) Structure and Applicable Securities Laws
Except as noted below, we assume that:

- The Eurobond has been issued pursuant to a trust deed governed by English law.
- The Eurobond was initially offered and distributed in compliance with exemptions from registration under the Securities Act.
- No previous exchange offer has been made in relation to the Eurobonds.

2. Position of Bondholder as Unsecured Creditor

(a) Generally
The bondholders of an unsecured Eurobond have a legal position (both prior to and during insolvency proceedings) broadly similar to the one described in Scenario A (*Unsecured Creditor*), except as noted below. The Eurobond holders are typically not secured creditors, insofar as they do not hold any security interest in property. Instead, they often receive credit support in the form of guarantees, as in this scenario.

(b) Bondholders' Rights and Obligations
These will be included in and subject to the provisions of the relevant trust deed and the loan agreement between the issuer and the borrower. The bondholders will have certain rights in relation to the adequacy of the disclosure in the offering memorandum. The bondholders will also have certain rights under the laws of the jurisdiction where the bonds were issued or offered and, if applicable, under the rules of the securities exchange where the bonds are listed.

(c) Priority and Subordination
Eurobonds are normally contractually subordinated to bank and other senior debt through payment blockage and standstill provisions. However, any obligations of a Russian guarantor will not be subordinated, as described in Section III.E.2 (*Intercreditor arrangements*).

3. Key Considerations for Eurobonds

(a) Negotiation Dynamics
A disparate group of investors may widely hold Eurobonds, increasing the difficulty for the issuer and the borrower to negotiate a restructuring. However, under the trust deed for the bonds, the trustee has the power to take certain actions on behalf of all bondholders, so long as a sufficient majority of bondholders support the particular action.

(b) Voting Thresholds
Voting thresholds are included in the trust deed and vary depending on the action proposed. Modifying payment terms normally requires approval by a two-thirds (sometimes a three-quarters) majority of the bondholders by value present and voting.

(c) Application of US Securities Laws
Transactions in Eurobonds, particularly those issued to US investors in reliance on an exemption under Rule 144A, may be subject to a variety of US securities laws. A discussion of such requirements is beyond the scope of this Practical Guide, but we would be pleased to advise on any situation in which US securities laws may be applicable.

4. Repurchasing the Eurobond

(a) Generally
If the issuer has or can obtain sufficient funding, it may be able to repurchase some or all of the bonds outstanding.

(b) Market Buyback
The issuer (or affiliate) can buy back Eurobonds on the market, so long as the buyback program complies with applicable law on trading in its own securities, *e.g.*, the Market Abuse Directive.[25] The acquisitions over certain thresholds may require a tender offer under applicable law.

(c) Cash Tender Offer
The issuer may also offer to the bondholders to repurchase the bonds — up to a stated amount — at a fixed price or a price determined by a formula. Tender offers must be carried out in compliance with applicable law.

(d) Exchange Offer
As a variation on the cash tender offer, the issuer may offer new debt securities in exchange for the original

bonds. The issue of the new securities must comply with applicable securities laws, and may require publishing an offering memorandum or prospectus.

(e) Buyback via Call Option
The bond documents may permit the borrower to repurchase the bonds by exercising a call option in accordance with the documents.

5. Debt-for-Equity Swaps

(a) Generally
Effectively, a D4E involving a Eurobond is simply an exchange offer in which part of the consideration is equity rather than cash or new debt.

(b) Securities Law Requirements
The offer of shares as consideration must comply with applicable securities laws, and may require publishing an offering memorandum or prospectus.

6. Taking Control of Debtor's Management
Generally: Because of the disparate nature of bondholders and their investment objectives, seeking control of management is likely impractical or undesirable. Nevertheless, if the group of bondholders is small enough to cooperate effectively, they would have a similar position to that described in Scenario A (*Unsecured Creditor*).

F. Non-convertible Interest-bearing Rouble Bond
Scenario: The issuer of non-convertible interest-bearing rouble bonds has defaulted on its obligation to buy back the bonds in accordance with the bondholders' put rights. Some of the bondholders have brought suit, the others are negotiating with the issuer on restructuring the debt.

1. Position of Bondholder as Unsecured Creditor
Generally: The bondholders of an unsecured rouble bond have a legal position (both prior to and during insolvency proceedings) broadly similar to the one described in Scenario A (*Unsecured Creditor*), except as noted below.

2. Key Considerations for Rouble Bonds

(a) Current Inability to Amend Terms of Rouble Bond
The procedure for amending the terms of a rouble bond is new to the Russian law and how it will operate is not fully clear. However, at present the bondholders and the borrower may enter into a side agreement containing revised terms, but the enforceability of such an agreement is an open question.

(b) Negotiation Dynamics
Because a disparate group of investors may hold the bonds widely, negotiating a restructuring at any stage may be difficult for the borrower and the key bondholders. Unlike with Eurobonds, rouble bonds have no trustee and contain no mechanisms for the bondholders to cooperate or to negotiate with the issuer.

(c) Race to the Courthouse
If some bondholders have filed suit, the others will likely want to do the same in order to preserve their rights. For example, the earliest to file will, if successful, be the first creditors able to obtain court orders permitting attachment of the issuer's assets and, potentially, to foreclose on them.

3. Repurchasing the Rouble Bond

(a) Generally
The borrower may be permitted, and in some cases required, to repurchase rouble bonds from the bondholders. Any repurchase requires an outlay of cash, for which the borrower may require outside financing, depending on the size of the buyback.

(b) Market Buyback
The borrower can buy back rouble bonds on the market so long as such acquisitions are permitted by the bond documents and are made in accordance with the regulations on bond tender offers.

(c) Cash Tender Offer
The borrower can offer to repurchase the bonds, up to a stated amount, at a price determined by the borrower. The legal position is the same as for the market buybacks, that is, the offer must comply with the bond documents and the regulations.

(d) Mandatory Buyback
The bond documents may require the borrower to repurchase bonds upon the exercise of put rights by the bondholders on the terms of the bond documents.

(e) Buyback via Call Option
The bond documents may permit the borrower to repurchase the bonds by exercising a call option on the terms of the bond documents. However, rouble bonds rarely include a call feature.

4. Restructuring the Rouble Bond via Exchange Offer

(a) Generally
As a variation on repurchases for cash, the borrower can offer a new bond with revised terms as consideration under the tender offer.

(b) Financing Required
The borrower cannot accept forgiveness of indebtedness, including its own bonds, as payment for newly issued securities. The transaction must be structured around this rule, which may require the borrower to borrow the funds to repurchase the old bonds, and then repay the loan with the proceeds of the subscription for new bonds. This movement of funds may raise clawback and other credit risks.

(c) Timing
Issue of a new rouble bond may take a significant period of time to complete, because it requires taking all required corporate actions to adopt a decision on issuance, prepare a prospectus and file the same for CBR's approval.

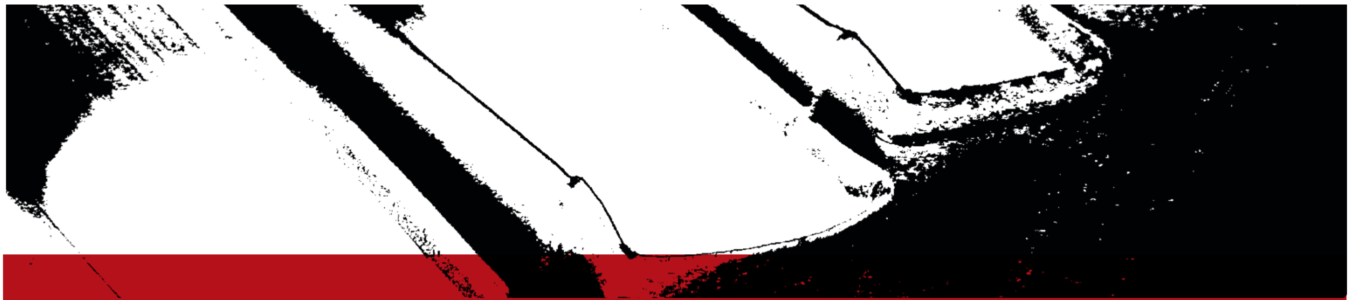
5. Debt-for-Equity Swaps

(a) Generally
Effectively, a D4E involving a rouble bond is an exchange offer in which part of the consideration is equity rather than cash or new debt.

(b) Determining Which Bondholders Receive Shares
A consensual D4E involving an exchange of rouble bonds for shares is likely to be carried out through the borrower's parent company transferring existing shares of the borrower to a substantial majority of the bondholders (instead of all the bondholders). The borrower must either repurchase those other bondholders' bonds or leave the bonds in place.

6. Taking Control of Debtor's Management

Generally: Because of the disparate nature of bondholders and their investment objectives, seeking control of management is likely impractical or undesirable. Nevertheless, if a group of bondholders were small enough to cooperate effectively, they would have a similar position to the one described in Scenario A (*Unsecured Creditor*).



V. ENFORCEMENT REGIMES FOR VARIOUS TYPES OF ASSETS

Type of pledge	Registration	Notarization	Methods of enforcement	Other considerations
Pledge of movables (including, but not limited to goods in circulation)	The pledge should be registered in the Register of Movables.	Notarization is not mandatory, but is advisable if the pledge agreement provides for out-of-court enforcement.	**Court** i) Public auction ii) Retention iii)Private sale without an auction **Out-of-court** i) Private auction ii) Retention ii) Private sale without an auction **Prerequisites for out-of-court enforcement** i) Provisions in the pledge agreement or a separate document setting out an out-of-court enforcement option and incorporating one of the permitted methods of out-of-court enforcement ii) Establishment of the starting price of the secured property or the method of its determination	• A pledgee does not generally need a power of attorney from the security provider to execute any documents necessary to effect the enforcement of the secured property, if the relevant provision is incorporated in the pledge agreement. • If the pledge of movables relates to goods in circulation (if the pledgor is allowed to dispose of and replace the pledged goods), the pledge needs to specify a type of goods pledged, their place of storage and amount of goods subject to pledge.

Type of pledge	Registration	Notarization	Methods of enforcement	Other considerations
Pledge of shares in joint stock companies (JSCs)	The pledge of shares must be recorded in the share register/ depositary account.	Notarization is not mandatory, but is advisable if the pledge agreement provides for out-of-court enforcement.	Enforcement of pledge over shares may be conducted in court or out-of-court. The rules on enforcement of such a pledge are substantially similar to the above rules on enforcement of a pledge of movables, however, specific rules would apply to listed securities.	• A pledge of shares in a JSC should be governed by Russian law for the purposes of enforcement. • In non-public JSCs shareholders' pre-emption rights may affect an enforcement of a pledge of shares. • Russian law now allows the pledgee to exercise corporate rights pertaining to the pledged shares, including voting rights and the right to receive dividends, prior to enforcement. • Following enforcement of the pledge, transfer of title to shares in JSCs needs to be recorded in the registrar or with the depository. • Setting out in detail enforcement formalities (such as documents required for enforcement) in the depository agreement between the pledgee and the depository (if applicable) is advisable. • Enforcement of a pledge may also trigger the requirement to obtain regulatory approvals or file notifications.

Type of pledge	Registration	Notarization	Methods of enforcement	Other considerations
Participatory interests pledge in limited liability companies (LLCs)	The pledge must be recorded in the Russian Unified State Register of Legal Entities (the EGRUL).	Notarization is mandatory.	Enforcement of pledge over participatory interests may either be conducted in court or out-of-court (the rules are substantially similar to the above rules on enforcement of a pledge of movables).	• A pledge of participatory interests in a Russian LLC should be governed by Russian law. • The entry into the pledge (and the encumbrance as the participatory interests) may be prohibited by the charter of an LLC. Typically the consent of the general meeting of the participants is required for the pledge. • Participants (other than the pledgee) may be allowed to exercise pre-emptive rights in respect of participatory interests upon enforcement (except if an LLC has only one participant). • Russian law now allows the pledgee to exercise corporate rights pertaining to the pledged shares, including voting rights and the right to receive dividends, prior to enforcement. • Following enforcement of the pledge, the transfer of title to the shares in the LLCs needs to be recorded with the EGRUL. • Enforcement of a pledge may also trigger the requirement to obtain regulatory approvals or file notifications.

Type of pledge	Registration	Notarization	Methods of enforcement	Other considerations
Mortgage	The mortgage needs to be recorded in the EGRP.	Notarization of the mortgage agreement is not mandatory, unless the mortgage agreement provides for out-of-court enforcement.	Enforcement of mortgage may either be conducted in court or out-of-court. The rules are generally similar to the above rules on enforcement of pledge of movables, however, certain methods of enforcement are not available. The timeline is generally lengthier and enforcement is generally subject to specific rules set out in the Mortgage Law. **Court** i) Public auction ii) Retention **Out-of-court** i) Private auction ii) Retention	• A mortgage of real estate located in Russia must be governed by Russian law. • Transfer of title to mortgaged assets needs to be recorded in EGRP upon enforcement of the mortgage agreement.

Type of pledge	Registration	Notarization	Methods of enforcement	Other considerations
Pledge of contract rights/receivables	The pledge should be registered in the Register of Movables.	Notarization of the pledge of contract rights/receivables agreement is not mandatory, but is advisable if the pledge agreement provides for out-of-court enforcement.	Enforcement of pledge over participatory interests may either be conducted in court or out-of-court (the rules are substantially similar to the above rules on enforcement of a pledge of movables).	• The pledge agreement needs to specify the pledged contract rights/receivables, the relevant contract, parties thereto and identify whether the pledgor or the pledgee holds documents underlying the pledged contract rights/receivables. • Pledge of contract rights/receivables may relate to rights under one contract, or a group of contracts, or may be limited by a certain amount of money. • Pledge of contract rights/receivables may be prohibited by the underlying contract, or may require consent of the debtor under the contract. If upon enforcement of pledge, the person acquiring contract rights/receivables must also undertake the obligations of the security provider before the debtor, the consent of the debtor for such pledge is always required. • Transfer of contract rights/receivables upon enforcement of pledge must be notified to the debtor under the contract, but for such notification, the debtor is entitled to perform to the initial creditor (the security provider) and not to the pledgee.

Type of pledge	Registration	Notarization	Methods of enforcement	Other considerations
Bank account pledge	Registration is not required.	Notarization is not mandatory, but is advisable.	Enforcement of pledge over participatory interests may either be conducted in court or out-of-court (with out-of-court enforcement requiring notice to the account bank).	• This type of pledge is a new type of security for Russia. Previously, only direct debit rights (which are contractual, revocable and do not create a security interest) were available to creditors. • The benefit of this type of pledge is relatively quick enforcement and quick access to funds, which may be used for repayment (without the need to conduct a sale or determine the market price of the security). • Security can be taken over a specific type of bank account (pledge account) opened by the pledgor with the bank acting as pledgee, or a third-party account bank. Pledge may be created in respect of all funds on the pledge account from time to time, or a fixed amount (in the latter case, such amount may be blocked on the account and may not be withdrawn). • Terms of the bank account agreement with respect to the pledge account, if the account is opened with a third-party bank and not the pledgee, cannot be amended without the consent of the pledgee.

Type of pledge	Registration	Notarization	Methods of enforcement	Other considerations
Pledge of IP rights	If an IP is registrable under Russian law, for instance in a case of patents or trademarks, the pledge needs to be recorded with Rospatent.	Notarization is not mandatory, but is advisable if the pledge agreement provides for out-of court enforcement.	Enforcement of pledge over IP rights may either be conducted in court or out-of-court (the rules are generally similar to the above rules on enforcement of pledge of movables).	• If a transaction involves a pledge of asset or a right of an obligor (whose shares are not pledged) and if such asset or right may not be completely used without holding certain IP rights or licenses, in a default scenario only enforcement over such IP rights or licenses would allow the pledgee or third parties to fully step into the shoes of the pledgor. • IP rights may be only pledged if they are transferable under Russian law. Enforcement over the authors' personal rights (i.e. right to be mentioned as the authors) is not allowed, as such rights are considered to be inalienable under Russian law. • When specifying the term of pledge, the term during which the pledged IP rights (licenses) are in force needs to be taken into account. • The pledge agreement needs to accurately specify the pledged IP. • Disposal (including pledge) of rights to use IP may also be restricted by the underlying license agreement. • Transfer of rights to registrable IP as part of enforcement of the relevant pledge agreement must be registered with Rospatent.

Latham & Watkins Russian Restructurings Team

Increasingly complex insolvency and restructuring transactions in Russia require coordination and substantive expertise from diverse practice areas. Latham & Watkins has the necessary breadth of practice to represent any major participant in a restructuring transaction or insolvency proceeding. In order to deliver a successful restructuring, the firm draws on our extensive legal expertise on global financial transactions.

Latham & Watkins' fully coordinated Restructuring, Insolvency & Workouts Practice has the resources to provide top-quality legal service in Russia, especially on matters with significant cross-border challenges. In addition, our lawyers draw on the firm's extensive involvement across the globe with every form of current finance structure to design and implement even the most complex financial restructurings for our clients.

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Endnotes

1 The Civil Code of the Russian Federation, Part 1 of the Civil Code of the Russian Federation No. 51-FZ dated 30 November 1994, as amended, Part 2 of the Civil Code of the Russian Federation No. 14-FZ dated 26 January 1996, as amended, Part 3 of the Civil Code of the Russian Federation No. 146-FZ dated 26 November 2001, as amended, and Part 4 of the Civil Code of the Russian Federation No. 230-FZ dated 18 December 2006, as amended.

2 Federal Law No. 99-FZ "Amending Chapter 4 Part I of the Civil Code of the Russian Federation and Providing for Expiry of Certain Provisions of Legal Acts of the Russian Federation" dated 5 May 2014.

3 Federal Law No. FZ-127 of 26 October 2002 "On Insolvency (Bankruptcy)", as amended.

4 Such as Federal Law No. 476-FZ of 29 December 2014 "Amending the Insolvency Law and separate legal acts of the Russian Federation regarding rehabilitation procedures applicable to individuals - debtors".

5 Including pledge over contract rights and bank accounts.

6 Notably, pursuant to the recent amendments to the Civil Code adopted on 21 December 2013, Federal Law No. 2872-1 of 29 May 1992 "On Pledge" is repealed starting from 1 July 2014 and its provisions are incorporated into the Civil Code.

7 Federal Law No. FZ-102 of 16 July 1998 "On Mortgage (Pledge of Immovable Property)," as amended.

8 Federal Law No. FZ-229 of 2 October 2007 "On Enforcement Proceedings," as amended.

9 If the security is a pledge of movables by an individual, or is a mortgage, the agreement must be accompanied by the notarized consent of the security provider, which consent may likewise be given at any time.

10 Federal Law No. 135-FZ dated 26 July 2006 "On Protection of Competition," as amended.

11 The proceedings are initiated when the arbitration court issues a decision accepting the petition for initiation of the proceedings and starting the supervision phase.

12 Any restructuring of a debt instrument must comply with applicable securities laws, which may impose requirements on the issuer to prepare documents for publication or filing with the relevant securities regulator.

13 Federal Law No. 39-FZ dated 22 April 1996 "On Securities' Market," as amended.

14 Other common jurisdictions for such parent companies include Luxembourg, the Cayman Islands, Bermuda, the Channel Islands and the Netherlands.

15 Where actual malfeasance is involved, the law provides remedies in principle, but in practice they may be ineffective to protect creditors' interests.

16 The right of appropriation is available under the laws of England, Cyprus and other EU jurisdictions which have implemented the Financial Collateral Directive (Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements). Because the focus of this Practical Guide is on a creditor's rights under existing security, and not on issues to be considered in structuring and documenting a security interest, the requirements for creating an enforceable right of appropriation are beyond the scope of this Practical Guide, and we assume that the requirements have been met.

17 The scope of persons who may be interested parties in relation to a Russian company, or affiliated or connected to an interested party, under the Joint Stock Companies Law is complex, and that definition of interested parties is expanded for the purposes of the Insolvency Law. The 20 percent voting threshold noted here is simply one means by which a person may be deemed interested. The secured creditor or parent company may be an interested party as a result of other factors as well. The details of these rules are beyond the scope of this Practical Guide. We would be pleased, however, to advise you separately on the detailed application of these rules.

18 Federal Law No. 208-FZ dated 26 December 1995 "On Joint Stock Companies," as amended.

19 Federal Law No. 14-FZ dated 8 February 1998 "On Limited Liability Companies," as amended.

20 The Insolvency Law would deem a company to be an interested party in relation to a debtor if that company holds a majority interest in the debtor or can — by agreement or otherwise — determine the debtor's corporate actions. Any company holding 20 percent or more of the (voting) share capital of the debtor would be an "interested party" under the Joint Stock Companies Law.

21 The Joint Stock Companies Law provides that if the debtor has fewer than 1,000 shareholders, a majority of the company's disinterested directors (if they are sufficient in number to form a quorum) must approve the transaction. However, only a majority of disinterested shareholders can give such approval if the transaction or a series of related transactions (i) has a value equal to two percent or more of the book value of the debtor's assets as recorded on its balance sheet prepared under Russian accounting standards, or (ii) involves the issuance, by subscription, of voting shares or securities convertible into voting shares, or secondary market sale of such securities, in an amount exceeding two percent of the debtor's issued voting shares. In addition, in the context of insolvency proceedings, the Insolvency Law deems all of the debtor's directors to be interested parties, and so disinterested shareholder approval would be required for all interested party transactions contemplated during such proceedings.

22 Disinterested shareholder approval is also not required if (i) the debtor has a single shareholder who acts as the debtor's sole executive body (although such shareholder would presumably vote to approve in any event), or (ii) the debtor is required to enter into the transactions under Russian law, and to conclude them on the basis of fixed prices and tariffs set by a government regulatory body.

23 E.g., a subsidiary or another affiliate of the borrower, such as the shareholder of the debtor's immediate parent.

24 The FBS is the federal executive body responsible for the orderly functioning of courts of law, the enforcement of court rulings and acts of other bodies and officials.

25 Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse). Bond buybacks are not subject to the provisions on buyback programs set out in the Buyback and Stabilisation Regulation (Commission Regulation (EC) 2273/2003 of 22 December 2003), which apply only to shares.

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