# INVESTMENT PROPERTY AS COLLATERAL: THE UNITED STATES VS RUSSIAN FEDERATION

By Pavel Figurov

LL.M. SHORT THESIS
COURSE: Comparative Secured Transactions Law
PROFESSOR: Tibor Tajti, S.J.D.
Central European University
1051 Budapest, Nador utca 9.
Hungary

## ABSTRACT

This thesis aims to analyze the existing rules on using investment property as collateral in the United States and Russia, to find differences and similarities, and to make propositions, if necessary, on amendment of Russian secured transactions law concerning investment property on the base of UCC Articles 8 and 9.

This thesis discusses the definition of investment property under UCC Article 9, procedure of creation and perfection of a security interest in investment property, as well as priority and enforcement rules according to the UCC; and compares them with relevant provision of Russian secured transactions and securities law. Eventually, this thesis shows that not all categories and rules used by the UCC are can be and should be transplanted to Russian legislation.

As the result, this thesis takes the position, that, despite of substantial differences, regulation of using investment property as collateral in the United States and Russia has a lot in common. In some aspects UCC rules are more elaborated and should be borrowed by the Russian legislator (for example, in case of uncertificated securities and public notice requirement), nevertheless, in several cases Russian Law provides even better solutions.

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# INTRODUCTION

The recent financial crisis of 2007-2008 once again proved that the securitization of obligations is the first thing creditors should think about. Only when an obligation is sufficiently secured, the creditor can be sure that he or she will receive all money due. Pledge, as one of the best and most effective methods of securing transactions,[1] has more advantages than other methods of securing, since the security agreement guarantees occurrence and safety of the pledged property and it gives priority over other creditors.[2] While it is possible to pledge almost any movables, in this thesis the focus will be on securities (and especially, investment securities), as one of the most valuable and liquid kinds of property.[3]

However, it is not enough just to secure the obligation, even with the pledge over security, because the main point is the enforceability of a created security interest, what, in turn, depends on local legislation. Hence, the improvement of secured transactions law in order to make it more sophisticated should be considered as one the main aims for countries with a developing economy, and Russia is not an exception.

It is always easier to use successful experience of other countries than develop legislation individually. Article 9 of the Uniform Commercial Code (UCC) is considered as the most comprehensive codification of the law of security interests in the world,[4] and with Revised Article 8, which complemented provisions of Article 9 on investment securities (as part of investment property) and using them as collateral, it almost completely satisfies works actual market needs.



[1] MARINA ZINOVIEVA & SERGEI GVOZDEV, INTERNATIONAL COMMERCIAL SECURED TRANSACTIONS 201 (David Franklin & Steven A. Harms eds., Toronto: Carswell 2010).
[2] M.I. BRAGINSKIJ & V.V. VITRJANSKIJ, DOGOVORNOE PRAVO, KNIGA PERVAJA: OBSHHIE POLOZHENIJA [Contract Law. Book One: General Provisions] 504-505 (2nd ed. Statut 2000).
[3] *See* James Steven Rogers, *Policy Perspectives on Revised U.C.C. Article 8*, 43 UCLA L. REV. 1431, 1477 (1995-1996).
[4] PHILIP R. WOOD, COMPARATIVE LAW OF SECURITY INTERESTS AND TITLE FINANCE 169 (London : Sweet & Maxwell 2007).

Therefore, it is worth looking at UCC Articles 8 and 9 as the possible model for improving Russian secured transactions law in connection with using investment property as collateral, especially, taking into account, the existing claims about necessity to improve current rules[5] and the fact that the Russian securities law was partially developed under the influence of UCC Article 8.

This thesis aims to analyze the existing rules on using investment property as collateral in the United States and Russia, to find differences and similarities, and to make it clear, whether Russian rules really should be amended and whether UCC Article 8 and 9 should be taken as a model. Of course, the Russian legal system substantially differs from the common law legal system and not all categories can be transplanted from the UCC to Russian legislation (for example, even the category of investment property is unknown in Russia, although it is possible with some exceptions to talk about similar category of investment securities). However, success of the UCC with a functional approach, security intermediaries, and security entitlements, categories of perfection and control, and unique priority and enforcement rules should be thoroughly examined in order to understand, how (and whether) the Russian market can benefit from the using of similar categories, and whether it is even possible to use these categories and unique rules in realities of Russian business.

As a result, this thesis takes the position that, despite substantial differences, regulation of using investment property as collateral in the United States and Russia has a lot in common, however, in some aspects UCC rules are more elaborated and may be borrowed by the Russian legislator. Nevertheless, in several cases Russian Law provides even better solutions.



[5] See Maksim E. Poskrebnev, Zalog Cennyh Bumag kak Sposob Obespechenija Ispolnenija Objazatel"stv [Pledge of Securities as a Method to Guarantee Performance of Obligations] (2005) (unpublished S.J.D. dissertation, Moscow Academy of Economics and Law) (on file with author).

Most current literature on secured transactions in the US covers all issues related to Articles 8 and 9, while most Russian work is dedicated to regulation of using securities (not exactly investment securities) as collateral, however, very few of them look at the possibility of using successful UCC experience for purposes of amendment of foreign, and particularly Russian, legislation. Hence, this paper is of serious relevance and will contribute to the field.

The thesis consists of two chapters. The first chapter is dedicated to an explanation of the current system of regulation of using investment property as collateral by UCC Article 8 and 9 in the United States, while the second chapter observes correspondent provisions in Russian Law with comparisons and references to the UCC, and relevant findings.

# CHAPTER 1 - USING INVESTMENT PROPERTY AS COLLATERAL IN THE UNITED STATES

## *1.1. The development of Revised Articles 8 and 9*

Today almost all aspects of the secured transactions with investment property as collateral are governed by Article 9 of the UCC with some important provisions in Article 8 (Investment securities): there can be found definitions of several types of investment property, explanations of control and delivery (which are methods of perfection of a security interest in investment property according to Article 9) and other provisions related to both direct and indirect holding systems. However, the UCC rules on secured transactions with investment property did not have such structure all the time. Moreover, because of changes in practices of trade and issuing securities, the UCC was amended substantively, at least, twice in 1977 and 1994 from the moment of it first adoption.[6] It may be useful to briefly examine reasons behind these amendments in order to better understand why the drafters chose so specific conceptions as, for example, "security entitlement."

### 1.1.1 1977 amendments

For a long time a certificate was the only evidence of a security ownership. And when a security was sold or used as collateral it had to be delivered to the purchaser or secured party: so, each transaction was followed by delivery of a certificate. Consequently, with inevitable enlargement of securities market, every day a huge amount of securities was traded



[6] JAMES J. WHITE, SECURED TRANSACTIONS: TEACHING MATERIALS 434 (3rd ed. St. Paul, MN : Thomson/West 2006).

and, therefore, a huge amount of certificates waited for delivery, what, in turn, was not very favorable.[7] New solutions were needed.

The drafters of the 1977 amendments attempted to solve the "paper crunch" problem which occurred because of the increased number of transactions with certificated securities; and "made room for the advent of uncertificated securities."[8] Of course, the uncertificated securities, like we know them now, existed prior to 1977 but they were general intangibles under Article 9 and not securities,[9] therefore, it was necessary to provide working and close to certificated securities rules on using uncertificated securities as collateral. Consequently, the drafters did not only introduce a new conception of "uncertificated security"; in an attempt to influence the using of uncertificated securities, they decided to transfer all secured transactions rules (such as attachment, perfection and enforceability) regarding both certificated and uncertificated securities to Article 8.[10]

Prior to the 1977 amendments, all issues regarding using securities as collateral were governed by Article 9 and a security interest in a certificated security was created and perfected by giving the creditor the possessions of the certificate while according to the amended Article 8 the security interest was perfected by transfer of the security.[11]

Despite attempts of the drafters to make a shift from certificated to uncertificated securities, the industry decided to act in another manner and introduced in the late 1960s the *indirect holding system* as an answer to the "paper crunch."[12] The new system let the issuers, traders and owners use the certificated securities and trade them without a necessity to deliver



[7] WHITE, *supra* note 6, at 435.
[8] RICHARD F. DUNCAN ET AL., THE LAW AND PRACTICE OF SECURED TRANSACTIONS: WORKING WITH ARTICLE 9 at 1-90 (New York, N.Y. : Law Journal Press 2011).
[9] *See* David I. Cisar, *Revised UCC Article 8 and Securities Interests in Investment Securities,* [14-10] ABIJ 20 (1995).
[10] DUNCAN ET AL., *supra* note 8, at 1-92.
[11] WHITE, *supra* note 6, at 434.
[12] Russel A. Hakes, *UCC Article 8: Will the Indirect Holding of Securities Survive the Light of Day?,* 35 LOY. L.A. L. REV. 661, 668 (2002).

the certificate every time after transaction. Such a result was achieved by using the common depository of the securities where all "jumbo" certificates are held – The Depository Trust Company (DTC). Securities usually are issued in the name of the DTC which, in turn, holds them for the intermediaries' (broker firms) customers (beneficial owners). Consequently, there is no need for delivery certificates or register transfer after securities trading; settlement occurs by computer entries in the records of the DTC,[13] therefore securities became not dematerialized but rather immobilized.[14] The new indirect system was very effective but the lack of legal regulation was one of incentives for the revision of UCC Articles 8 and 9.

Besides that, the amended UCC Article 8 rules also were not very effective for trading uncertificated securities because transfer agents had to be involved in each transaction. And taking into account the amount of separate issuers and transfer agents in the United States, it was very difficult to coordinate and net the transactions.[15] Moreover, the transfer of provisions regarding secured transactions from Article 9 to Article 8 harmed the functional approach of the UCC by separating body of the secured transactions law.[16]

### 1.1.2 Revised Articles 8 and 9

It was clear not only for the drafters but for all market players that UCC Article 8 had to be amended again. There were no appropriate rules for regulation of the current market realities which led to the legal uncertainty and possibility of systemic risk.[17] Therefore, in 1994 both Articles 8 and 9 were substantially revised.



[13] WILLIAM D. WARREN & STEVEN D. WALT, SECURED TRANSACTIONS IN PERSONAL PROPERTY 408 (7th ed. Found. Press Thomson/West 2007).
[14] *See* Hakes, *supra* note 12, at 668.
[15] Curtis R. Reitz, *Investment Securities: The New UCC Article 8 for Delaware* , 1 DEL. L. REV. 47, 50 (1998).
[16] *See* DUNCAN ET AL., *supra* note 8, at 1-93.
[17] *See* Hakes, *supra* note 12, at 665.

First of all, all rules regarding the secured transactions using investment property as collateral (creation, perfection, priority and new conception of control) were simplified and moved back to Article 9 in section 9-115,[18] while Article 8 was dedicated to direct and indirect holding systems of securities. However, it was not the only change. Article 8 introduced a whole set of new definitions and terms related to indirect holding system such as "securities intermediary," "security entitlement," "entitlement holder," "financial asset" and "securities account"; and created a new legal framework for this system.

And what is important for the topic of this research is that the new category of "investment property" was created. This category embodied not just certificated and uncertificated securities but also securities accounts, security entitlements, as well as commodity contracts and commodity accounts.

It is worth emphasizing the reasons why the drafters have changed the Articles 8 and 9. The 1977 amendments were supposed to resolve problem of "paper crunch," while 1994 amendments created a legal background for already existed marker. In other words, the market practices did not changed because of the new amendments, the law, *vice versa*, was changed because of the market. On the other hand, Russian market practices very often changes exactly because of new law and amendments.[19]



[18] In 1999 rules regarding secured transactions with investment property were relocated from section 9-115 to other sections of Article 9.

[19] *See* TOP 4*10: Ratings of Changes Made to Russian Business Legislation in 2006 prepared by the BEITEN BURKHARDT Rechtsanwaltsgesellschaft mbH (2007), http://www.bblaw.com/uploads/media/January_Top_40.english.pdf.

### *1.2 What is investment property?*

Prior to describing what investment property is and, particularly, what kinds of investment property can be the collateral under the UCC, a specific feature of the UCC should be noted – a functional approach or "function over form" approach. It does not matter what is the title of a document or a contract, UCC Article 9 applies to "a transaction, regardless of its form, that creates a security interest in … [investment property] by contract,"[20] and regardless of the name the parties have given to it.[21] In other words, every transaction that serves the economic function of creating a security interest is governed by UCC Article 9 irrespective of title and the form of the document, irrespective of used words and definitions in the contract, even irrespective of intentions of the parties. Such an approach has a lot of advantages; it makes rules more simple, understandable and accessible because there is no need to examine several distinctive statutes which, in general, govern the same transactions but with different types of collateral. Consequently, there is more legal predictability because of the unified body of secured transactions law and it is easy to obtain a credit.[22] Moreover, because it was impossible to predict what forms of transactions will be invented after the enactment of the UCC rules, it was very important to "base the rules on general structural factors rather than on factors specific to particular transactions patterns or specific categories of actors."[23]

Turning back to investment property, first of all, it is necessary to understand what exactly investment property is. It is necessary not only for the aim of this research; a complete understanding of the meaning of the term "investment property" is vital for the practice. For



[20] UCC s. 9-109(a)(1).
[21] Official Comment 2 to UCC s. 9-109.
[22] N. ORKUN AKSELI, INTERNATIONAL SECURED TRANSACTIONS LAW: FACILITATION OF CREDIT AND INTERNATIONAL CONVENTIONS AND INSTRUMENTS 92 (Taylor & Francis 2011).
[23] Rogers, *supra* note 3, at 1477.

example, one can mistakenly rely on the priority rules relevant only for the investment property when, in fact, one deals with other but very similar kinds of property.[24]

It can be said that the term "investment property" includes "stocks, bonds, brokerage accounts (including commodity brokerage accounts), mutual funds, and the like"[25] but it seems necessary to look into this term more thoroughly.

The official definition of the term "investment property" can be found in section 9-102(a)(49) of UCC Article 9. According to this section, "'investment property' means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract and commodity account."[26]

### 1.2.1 Security

The UCC describes a security as "an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer"[27] which meets three requirements. First, it should be "represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer."[28] Second, it should be "one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations."[29] And finally, it should "[be], or [be] of a type, dealt in or traded on securities exchanges or



[24] *See*, for example, *In re* Turley, 172 F.3d 671 (9th Cir. 1999). The main issue of the case was whether the share certificate with the affirmative obligations to race and the other restrictions contained in the franchise agreement was a certificated security of a type that was generally traded in markets and exchanges. The court held that this certificate was a general intangible and not a security.
[25] ROBERT M. LLOYD & GEORGE W. KUNEY, SECURED TRANSACTIONS: UCC ARTICLE 9 & BANKRUPTCY 311 (Univ. of Tenn. Coll. of Law 2008).
[26] UCC s. 9-102(a)(49).
[27] *Id*. s. 8-102(a)(15).
[28] *Id*. s. 8-102(a)(15)(i).
[29] *Id*. s. 8-02(a)(15)(ii).

securities markets; or be a medium for investment and by its terms expressly provides that it is a security governed by [Article 8]."[30]

According to this definition we can understand by securities stocks in publicly traded corporations and debts (e.g. bonds); however, this definition covers not only these types of securities. Some useful rules on determining what exactly security is can be found in section 8-103[31]; nevertheless, it seems necessary to cover some important issues.

Certificated security. When the UCC was amended in 1977 it was thought that soon most securities would be issued in an uncertificated form, however, "today stocks issued by most American companies are certificated."[32]

The security is certificated when it is represented by a certificate whether in *bearer* or *registered form*. According to the UCC a certificate is in *bearer form* when "a security is payable to the bearer of the security certificate according to its terms."[33] And a certificate is in *registered form* when the "security certificate specifies a person entitled to the security; [and] a transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states."[34]

In contrast with certificated securities, uncertificated securities are simply not represented by any certificate. When there is no certificate, the transfer of such securities is registered upon books maintained for that purpose by or on behalf of the issuer. Examples of



[30] UCC s. 8-102(a)(15)(iii).
[31] *Id.* s. 8-103.
[32] JAMES J. WHITE & ROBERT S. SUMMERS, PRINCIPLES OF SECURED TRANSACTIONS 76 (St. Paul, MN : Thomson/West 2007).
[33] UCC s. 8-102(a)(2).
[34] *Id.* s. 8-102(a)(13).

uncertificated securities are mutual funds and corporate bonds held in electronic book entry form.[35]

Interests in limited liability companies. At first sight Article 8 makes it clear that "an interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets or its terms expressly provide that it is a security governed by [Article 8], or it is an investment company security."[36] Generally interests in LLCs are not securities "because members' interests are commonly uncertificated and are rarely traded on securities markets. … Hence, these interests are usually treated as general intangibles."[37] Nevertheless, though the UCC contains strict and clear provisions for cases when an interest in LLC is a security, in *Greenstreet Fin., L.P. v. CS-Graces, LLC*[38] the court decided that an interest in LLC was a security while it did not met all requirements of section 8-103(c).[39]

Shares in close corporations. Though shares in close corporations are not dealt in or traded on securities exchanges or securities markets, such shares still are securities. The phrase "of a type" allows including of stocks of closely-held corporations "within the definition [of a security] even though they are not actually traded on exchanges."[40]



[35] *See* WARREN & WALT, *supra* note 13, at 438.
[36] UCC s. 8-103(c).
[37] *See* WARREN & WALT, *supra* note 13, at 414.
[38] Greenstreet Fin., L.P. v. CS-Graces, LLC, 2011 U.S. Dist. LEXIS 44919 (S.D.N.Y., Apr. 18, 2011).
[39] *See* Howard Darmstadter, *Investment Securities*, 67 BUS. LAWYER 1299, 1300 (August 2012) for analysis of this case; *See also* John Alan Lewis, *The Pledge of Partnership and LLC Interests. A Trap for Lenders and Borrowers?*, 45 THE ARK. LAWYER 11 (Fall 2010).
[40] *See* DUNCAN ET AL., *supra* note 8, at 1-91.

### 1.2.2 Security entitlement

The vague definition of the "security entitlement" – "the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5 [of Article 8],"[41] requires more detailed examination.

Actually, the term "security entitlement" refers to an indirect-holding system when a securities intermediary holds securities for its customer (which is an entitlement holder). The entitlement holder has some rights and property interest in securities held by the security intermediary. These rights and property interest is the security entitlement. Therefore, the person does not hold securities in an account of the securities intermediary (i.e. the person is not the holder of securities) but the person has a security entitlement.[42] This distinction is very important because direct holders of securities and entitlement (indirect) holders have different rights according to UCC Article 8.[43]

### 1.2.3 Securities account

The definition of the term "securities account" can be found in section 8-501 of UCC Article 8 according to which a securities account is "an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset."[44]



[41] UCC s. 8-102(a)(17).
[42] *See* Official Comment to UCC s. 8-501.
[43] *See*, for example, *In re* County of Orange, 219 B.R. 543; 1997 Bankr. LEXIS 2240; 36 U.C.C. Rep. Serv. 2d (Callaghan) 181 (Bankr. C.D. Cal. 1997) and Robert A. Wittie, *Recent Case Law Developments in U.C.C. Article 8 and Investment Securities* , 54 THE BUS. LAWYER 1921 (August 1999) for analysis of this case. *See* Hakes, *supra* note 12, at 686.
[44] UCC s. 8-501(a).

In other words, a securities intermediary holds securities and other financial assets for an entitlement holder in a securities account. In an Official Comment to the UCC it is explained that the securities account is included into the definition of the "investment property" "in order to facilitate transactions in which a debtor wishes to create a security interest in all of the investment positions held through a particular account rather than in particular positions carried in the account."[45]

There are some examples of the securities account relationships: a relationship between a clearing corporation such as Depository Trust & Clearing Corporation and its participant, a relationship between Merrill Lynch (broker) and the ABC Company (its customer) who leaves securities with the broker, and Bank of America acting as securities custodian and its custodial customers.[46] However, the definition of securities account excludes trust relationships in which the legal title is held by the trustee, mutual funds, deposit accounts and relationships created by a guaranteed investment contract.[47]

### 1.2.4 Commodity contract

Commodity contract is defined in the UCC as "a commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract if [such] contract or option"[48] which meets following requirements: (a) it is "traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to federal commodities laws" [49]; or (b) it is "traded on a foreign commodity board of



[45] Official Comment 6 to the UCC s. 9-102.
[46] *See* Official Comment 1 to the UCC s. 8-501.
[47] *See* Hakes, *supra* note 12, at 680.
[48] UCC s. 9-102(a)(15).
[49] *Id*. s. 9-102(a)(15)(a).

trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer."[50]

Technically "commodity contracts are not securities of any form whatsoever under Article 8"[51] and they are different from securities or other financial assets although they are traded on an exchange just like securities.[52]

Usually under the terms of a commodity contract a person agrees to buy or sell a set amount of commodity such as tea or wheat at a predetermined price for delivery at a future time. Such a contract may become either advantageous or disadvantageous depending on fluctuation of the price of the commodity.[53]

### 1.2.5 Commodity account

According to section 9-102(a)(14) "commodity account" means "an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer."[54] In general terms, a commodity account is the analogous to the securities account but with commodity contracts instead of security entitlements.



[50] UCC s. 9-102(a)(15)(b).
[51] JAMES BROOK, SECURED TRANSACTIONS: EXAMPLES AND EXPLANATIONS 201 (3rd ed. New York : Aspen Publishers 2005).
[52] *See* RICHARD H. NOWKA, MASTERING SECURED TRANSACTIONS: UCC ARTICLE 9 at 52 (Carolina Academic Press 2009).
[53] Official Comment 6 to the UCC s. 9-102.
[54] UCC s. 9-102(a)(14).

### *1.3 Attachment of security interest*

Attachment of a security interest is the first step to make it enforceable. Without attachment it is impossible to perfect the security interest, to make it enforceable against other creditors.

The description of attachment is given in section 9-203(a) of Article 9. According to this section "a security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment."[55]

A security interest is attached when: (1) value has been given (for example, the secured party gives value when it loans money to a debtor),[56] (2) "the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party"[57] (however, it is not necessary to have full ownership)[58]; and (3) "one of the following conditions is met: (a) the debtor has authenticated a security agreement that provides a description of the collateral"[59] (the security agreement is authenticated when it is signed or analogous action is made when the contract is not in written but other (e.g. electronic) form[60]; additionally, in case of consumer transactions it is insufficient to describe the collateral as "securities account" or "investment property")[61]; or (b) "the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party or the



[55] UCC s. 9-203(a).
[56] *See* WARREN & WALT, *supra* note 13, at 44; *See* UCC s. 1-204(4) for the definition of "value."
[57] UCC s. 9-203(b)(2).
[58] *See* Official Comment 6 to s. 9-203(b).
[59] UCC s. 9-203(b)(3)(a).
[60] *Id*. s. 9-102(a)(7).
[61] LINDA J. RUSCH & STEPHEN L. SEPINUCK, PROBLEMS AND MATERIALS ON SECURED TRANSACTIONS 420 (2nd ed. St. Paul, MN : Thomson/West 2010).

collateral is investment property, and the secured party has control pursuant to the debtor's security agreement."[62]

Additionally, when a security interest in a securities account or commodity account is attached, security interests in security entitlements and commodity contracts are attached simultaneously.[63]

Moreover, "a security interest in favor of a securities intermediary attaches to a person's security entitlement if the person [buying] a financial asset … is obliged to pay the purchase price to the securities intermediary …; and the securities intermediary credits the financial asset to the buyer's securities account …"[64]

After the security interest is attached the secured creditor is already able to enforce against the debtor upon a default, however, to have priority over other secured creditors, the secured creditor should perfect the security interest.

### *1.4 Perfection*

As was mentioned above, to attach a security interest is usually not enough for the creditor to feel safe and really "secured." To give a creditor's claim more priority than other ones, to protect the secured party against claims of other creditors this security interest shall be perfected. However, in some cases it is necessary to perfect the security interest if the secured party wants to preserve it. For example, if the secured creditor has not perfected security interest in a certificated security, a buyer of such a security takes it free of a security

[62] UCC s. 9-203(b)(3)(B).
[63] *Id.* s. 9-203(h), s. 9-203(i).
[64] *Id.* s. 9-206(a).

interest if the buyer gives value and receives delivery of the collateral without knowledge of the security interest.[65]

In general, the filing of a financial statement with the appropriate state office is the main method of perfection; however, it is not the case with investment property. There are several methods of perfection of a security interest in investment property and it is very important to choose a method very carefully because priority of the claims depends on a method of perfection. The two main methods are perfection by control and by filing, and in one case only the security interest can be perfected by delivery. Besides that, in several cases the security interest can be perfected automatically upon the attachment. Moreover, the UCC provides an opportunity for temporary perfection without filing, control or delivery.

### 1.4.1 Filing

It is always possible to file a financial statement to perfect a security interest in an investment property; however, it is "not necessarily the best way to go"[66] because of priority rules. Although, it may be a good alternative in situation with a trustee in bankruptcy.[67]

In comparison with control it looks that the filing as a method of perfection is almost useless for investment property, however, it is still better to file a financial statement even after obtaining control or delivery of certificate (continuous perfection)[68] because perfection by control and delivery lasts until the secured party has control or possession of a collateral



[65] UCC s. 9-317(b).
[66] BROOK, *supra* note 51, at 201.
[67] *See* LOUIS F. DEL DUCA ET AL, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE AND INTERNATIONAL COMMERCE 69 (Cincinnati, Ohio : Anderson Pub. Co. 2002).
[68] UCC s. 9-308(c).

while a filed financing statement is effective for a period of five years after the date of filing.[69]

### 1.4.2 Control

According to section 9-314(a) "a security interest in investment property … may be perfected by control of the collateral."[70] However, section 9-203(b) shows that obtaining control can also be a method of attachment.

For the drafters of the Revised Article 8 it was clear that original concept of possession could not meet the problems raised by uncertificated securities and indirect holding of securities, for this reason the control doctrine was invented.[71] As White & Summers explained, "control' is to intangibles as 'possession' is to goods."[72] That is why many rules related to perfection by possession are also relevant to perfection by control. For instance, perfection by control provides a better priority than perfection by filing (the same rule is true for perfection by possession), and like perfection by possession perfection by control lasts until the secured party does not have control. However, there is at least one difference: a secured party can still have control although the debtor has access to the investment property.[73]

In general, the purpose of control the same as purpose of filing a financial statement: is to make it obvious to all other persons that the secured party has rights in the collateral.[74] However, there is a serious distinction between these two methods of perfection, filing of the financial statement does not allows to the secured creditor to sold the collateral quickly, while



[69] UCC s. 9-515(a).
[70] *Id*. s. 9-314(a).
[71] *See* WARREN & WALT, *supra* note 13, at 412.
[72] Cited in DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON SECURED TRANSACTIONS 144 (6th ed. New York : Aspen Publishers 2003).
[73] *See* RUSCH & SEPINUCK, *supra* note 61, at 251.
[74] *See* WHALEY, *supra* note 72, at 108.

it's the characteristic feature of the control is that the secured party "can have the securities sold, without further action by the owner."[75]

Section 8-106 establishes different rules of gaining control for different types of investment property.

In cases of *certificated security in bearer form* a secured party has control if the certificated security is delivered to it.[76] A *certificated security in registered form* shall be also delivered to the secured party and one of following conditions shall be met: "the certificate is indorsed to the [secured party] or in blank by an effective indorsement[77]; or the certificate is registered in the name of the [secured party], upon original issue or registration of transfer by the issuer."[78]

It is necessary to add, what it means – to deliver a security. According to section 8-301(a) the certificated security is delivered when the secured party acquires possession of it; or when a third person, other than a securities intermediary, "either acquires possession of the security certificate on behalf of the secured party or, having previously acquired possession of the certificate, acknowledges that it holds for the [secured party]."[79] As can be seen, there is no obligation for such a third person to acknowledge that it holds the certificate for the secured party, therefore, the secured party in this case shall attach or perfect its security interest with other method.[80]

Additionally, the certificate in a registered form is delivered when "a securities intermediary acting on behalf of the [secured party] acquires possession of the certificate

[75] Official Comment 1 to the UCC s. 8-106.
[76] UCC s. 8-106(a).
[77] *See id*. s. 8-107 for the description of an "effective endorsement."
[78] *Id*. s. 8-106(b).
[79] *Id*. s. 8-301(a).
[80] NOWKA, *supra* note 52, at 49.

which is registered in the name of the [secured party], payable to [its] order, or specially indorsed to [it] by an effective indorsement and has not been indorsed to the intermediary or in blank."[81]

To have control of an *uncertificated security* it should be delivered to the secured party; or "the issuer should have agreed that it will comply with instructions originated by the secured party without further consent by the registered owner."[82] The uncertificated security is delivered when "the issuer registers the [secured party] as the registered owner, upon original issue or registration of transfer"[83]; or "a person, other than a securities intermediary, either becomes the registered owner of the security on behalf of the [secured party] or, having previously become the registered owner, acknowledges that it holds for the [secured party]."[84]

If the secured party either "becomes the entitlement holder; or the securities intermediary has agreed that it will comply with [secured party's] entitlement orders without further consent by the original entitlement holder",[85] or "another person has control of the security entitlement on behalf of the [secured party] or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the [secured party],"[86] it means that the secured party has control of a *security entitlement*. Additionally, the securities intermediary has automatic control on a security entitlement when an interest in the security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary.[87]



[81] UCC s. 8-301(a)(2).
[82] *Id*. s. 8-106(c).
[83] *Id*. s. 8-301(b)(1).
[84] *Id*. s. 8-301(b)(2).
[85] *Id*. s. 8-106(d)(2).
[86] *Id*. s. 8-106(d)(3).
[87] *Id*. s. 8-106(e).

A secured party has control of a *commodity contract* if "[it] is the commodity intermediary with which the contract is carried; or the commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the customer."[88]

"A secured party having control of all security entitlements or commodity contracts carried in a securities account or commodity account has control over the *securities account or commodity account*."[89] Moreover, if the secured party, debtor and securities or commodity intermediary agree that the intermediary will honor the secured party's instructions in respect of the account without further consent of the debtor, there is also control over the securities account or commodity account.[90]

Perfection by control is effective since the moment of obtaining control until the secured party loses control. However, some additional requirements should be met for the end of control. So, the perfection by control is not effective: in the case of a *certificated security* if "the debtor has or acquires possession of the security certificate"[91]; in the case of an *uncertificated security* if "the issuer has registered or registers the debtor as the registered owner"[92]; or in the case of a *security entitlement* if "the debtor is or becomes the entitlement holder."[93] Why does the secured creditor still have control of the investment property even if it does not met the requirements of establishment control? The possible answer is to make the secured creditor be able to repledge the collateral.[94]



[88] UCC s. 9-106(b).
[89] *Id*. s. 9-106(c).
[90] Official Comment 4 to the UCC s. 9-106.
[91] UCC s. 9-314(c)(2)(A).
[92] *Id*. s. 9-314(c)(2)(B).
[93] *Id*. s. 9-314(c)(2)(C).
[94] Robert A. Wittie, *Review of Legislative Developments Affecting U.C.C. Article 8 and Investment Securities*, 53 BUS. LAW. 1511, 1517 (1997-1998).

Definitely perfection of a security interest by control is more complicated than perfection by other methods, though it is worth the cost because the perfection by control provides higher priority of the security interest.

It should be noted that control, as a method of perfection, not always solves the problem of ostensible ownership, and sometimes (in cases of automatic control of intermediary) it is impossible for other parties to find out, whether the security interest in securities is perfected.[95]

### 1.4.3 Delivery

According to section 9-313 it is possible to perfect a security interest in certificated securities by delivery of such securities. However, in case of a certificated security in bearer form delivery is equal to control[96] and only for certificated security in registered form the delivery is something different.[97] The security interest "remains perfected by delivery until the debtor obtains possession of the security certificate."[98]

The delivery as a method of perfection has its advantages and disadvantages. It is easier to perfect the security interest by delivery than by control because for perfection by control is necessary not only deliver the certificate but also the certificate shall be indorsed to the secured party or in blank by an effective indorsement; or the certificate shall be registered in the name of the secured party, upon original issue or registration of transfer by the issuer,[99] however, "a secured party who perfects a security interest in investment property by control has a higher priority"[100] but it is difficult to imagine situation when the security interest in the



[95] *See* WARREN & WALT, *supra* note 13, at 101; RUSCH & SEPINUCK, *supra* note 61, at 251.
[96] *See* UCC s. 8-106(a) and s. 8-301(a).
[97] *See id.* s. 8-106(b) and s. 8-301(b).
[98] *Id*. s. 9-313(e).
[99] *Id*. s. 8-106(b).
[100] *See* NOWKA, *supra* note 52, at 50.

certificated security simultaneously perfected by delivery and by control by different secured parties.[101] Moreover, it is not easy to establish time of delivery in contrast to time of filing. This is important because "priority frequently depends upon the time of perfection."[102] Nevertheless, the security interest perfected by delivery has higher priority than the interest perfected by filing.

### 1.4.4 Automatic perfection

In some cases it is not necessary to take any steps to perfect a security interest after attachment. For instance, a security interest is perfected when it attaches if the control is obtained or the certificate is delivered before the security interest attaches.[103]

The reason why possibility of automatic perfection was added to the UCC, according to the drafters, is that "the cost of requiring notice would greatly exceed any benefit it produced."[104] Nevertheless, automatic perfection may fix the other creditors with costs of examining whether there is security interest and whether it is perfected because automatic perfection may give insufficient notice to the public.[105]

Section 9-309 also contains several rules on automatic perfection. So, "a security interest arising in the delivery of a financial asset under section 9-206(c)"[106] is perfected automatically. Additionally, "a security interest in investment property created by a broker or securities intermediary" is perfected when it is attached[107] as well as "a security interest in a commodity contract or a commodity account created by a commodity intermediary."[108] The



[101] *See* WHITE & SUMMERS, *supra* note 32, at 183.
[102] RUSSEL A. HAKES, THE ABCS OF THE UCC. REVISED ARTICLE 9, SECURED TRANSACTIONS 54 (Amelia H. Boss ed., Section of Bus. Law, Am. Bar 2000).
[103] UCC s. 9-308(a).
[104] *See* RUSCH & SEPINUCK, *supra* note 61, at 253.
[105] *Id.*, at 253.
[106] UCC s. 9-309(9).
[107] *Id.* s. 9-309(10).
[108] *Id.* s. 9-309(11).

reason for these rules is the necessity of credit in securities market; hence, it is easier to obtain the credit for intermediaries.[109]

Moreover, if a security interest in a securities account is perfected, it means that a security interest in the security entitlements carried in the securities account is also perfected.[110] The same is true for the commodity contracts carried in a commodity account.[111]

### 1.4.5 Temporary perfection

According to section 9-312(e) "a security interest in certificated securities is perfected without filing or the taking of possession or control for a period of twenty days from the time it attaches to the extent that it arises for new value[112] given under an authenticated security agreement."[113]

This "perfected security interest remains perfected for twenty days without filing if the secured party delivers the security certificate to the debtor for the purpose of ultimate sale or exchange; or presentation, collection, enforcement, renewal, or registration of transfer."[114] After the twenty-day period for the security interest be perfected it is necessary to file a financial statement, obtain control or deliver the certificate.[115] However, it is better for the secured party to perfect the security interest, at least, by filing prior delivery of the security certificate to the debtor in order to have continuously perfection.[116]



[109] HAKES, *supra* note 102, at 59.
[110] UCC s. 9-308(f).
[111] *Id*. s. 9-308(g).
[112] According to UCC s. 9-102(a)(57) "new value" means (i) money, (ii) money's worth in property, services, or new credit, or (iii) release by a transferee of an interest in property previously transferred to the transferee. The term does not include an obligation substituted for another obligation.
[113] *Id.* s. 9-312(e).
[114] *Id*. s. 9-312(g).
[115] *Id*. s. 9-312(h).
[116] RUSCH & SEPINUCK, *supra* note 61, at 259.

### *1.5 Priority rules*

In general, Article 9 states that for all types of collateral (with a few exceptions) priority depends on time of perfection but it is not the case with investment property where it is not the time of perfection that matters but the manner of perfection.[117] Consequently, the priority rules for investment property are very important because for the secured creditor it is possible to perfect a security interest by several methods.[118]

Most of the priority rules governing priority among conflicting security interests in the same investment property are contained in section 9-328.

First of all, one needs to remember the simple rule: control-beats-non-control, which means that a security interest perfected by control always has a priority over a conflicting interest perfected by other method, even if perfected earlier or if the creditor had knowledge about security interest perfected earlier.[119] Moreover, in general "a creditor who gets control is often second in time but first in right."[120]

In turn, priority between several secured parties each of which has control of the investment property depends on time of obtaining of control (first in time, first in right policy).[121] However, if the secured party is the securities intermediary who has control of a security entitlement or a securities account maintained with the securities intermediary, such intermediary has higher priority even if other secured party has established control earlier (same rule is effective for the commodity intermediary who has control of a commodity contract or a commodity account).[122] This priority is given to the securities and commodity



[117] *See* BROOK, *supra* note 51, at 356.
[118] WHITE & SUMMERS, *supra* note 32, at 182.
[119] UCC s. 9-328(1); HAKES, *supra* note 102, at 104.
[120] WHITE & SUMMERS, *supra* note 32, at 182.
[121] UCC s. 9-328(2).
[122] *Id.* s. 9-328(3), 9-328(4).

intermediaries "because of their close relationship to the collateral"[123] and it helps "facilitate the operation of highly liquid securities and commodity markets."[124]

If several brokers, securities intermediaries or commodity intermediaries have created conflicting securities interest but have not perfected it by control, such security interests rank equally.[125] Hence, every secured creditor has a right to receive its *pro rata* share in the collateral,[126] which can be considered as an incentive for brokers and intermediaries to perfect by control.[127]

Not only security interest perfected by control has priority over a conflicting security interest. So "a security interest in a certificated security in registered form which is perfected by taking delivery … and not by control … has priority over a conflicting security interest perfected by a method other than control" (e.g. by filing).[128]

If a security interest in the investment property is not perfected by control or delivery, section 9-322 contains rules for designation of priority of such security interest. First, the rule "first-in-time-first-in-rights" is accurate for filing and other methods of perfection (e.g. automatic perfection) of a security interest in the investment property.[129] Second, if a security interest is not perfected it is subordinated to a perfected security interest irrespective of method of perfection.[130] Third, priority between unperfected security interests depends on time of attachment of the security interest.[131]



[123] HAKES, *supra* note 102, at 104.
[124] *Id.*, at 105.
[125] UCC s. 9-328(6).
[126] NOWKA, *supra* note 52, at 200.
[127] Hakes, *supra* note 12, at 772.
[128] UCC s. 9-328(5).
[129] *Id*. s. 9-322(a)(1).
[130] *Id.* s. 9-322(a)(2).
[131] *Id.* s. 9-322(a)(3).

It should be noted that priority disputes may arise not only between secured parties having security interests in the same collateral, an entitlement holder also may be involved in such a dispute with a securities intermediary-debtor's secured creditor.

In general, it is prohibited for securities intermediaries to use the security entitlements of other customers as collateral for their own purposes[132]; however, if the securities in the account are not paid in full by the entitlement holder to the securities intermediary (when the intermediary loaned a part of purchase price of the securities), the securities intermediary is able to use that unpaid-for portion as collateral.[133] So, there is possible a priority dispute between the entitlement holder and the secured creditor of the securities intermediary. And according to section 8-511, the secured creditor's security interest in the financial asset has priority if the creditor has control, and if not, then the entitlement holder's claim has priority.[134]

### *1.6 Enforcement*

All the previous secured party's actions such as attachment and perfection of a security interest in the investment property will really matter when the debtor is in default. This is the moment when the secured party is able to enforce its claims against the debtor with respect to the collateral.

The secured party has several options. It may "reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest … by any available judicial procedure"[135]; it

[132] UCC .s. 8-504(b).
[133] *See* Reitz, *supra* note 15, at 62.
[134] UCC s. 8-511(a), 8-511(b). *See* Hakes, *supra* note 12, at 775 for discussion on conflicts in priority rules in section 8-511.
[135] UCC s. 9-601(a)(1).

also "may take possession of the collateral" [with or] without judicial process if it proceeds without breach of the peace"[136]; it may "sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing"[137] taking into account federal and state investment property sales rules[138]; and finally, it may "accept collateral in full or partial satisfaction of the obligation" but only if the debtor consents to it; and there is no objection from any "other person, other than the debtor, holding an interest in the collateral subordinate to the security interest that is the subject of the proposal (strict foreclosure)."[139] The last procedure may be the best choice for both the debtor and secured party because strict foreclosure is a cost-effective, "cheaper and faster way of realizing on collateral."[140]

In view of the foregoing considerations UCC Articles 8 and 9 provide comprehensive market orientated regulation of using of investment property as collateral. All provisions are the unified body of secured transactions law and drafted in the way to provide the parties of such transactions with convenient and working rules.

It is necessary now to examine relevant provisions of the Russian secured transactions law in order to understand, whether UCC provisions on investment property, attachment and perfection of a security interest in it, specific priority and enforcement rules could be and should be transplanted into the Russian Law for the purpose of making Russia a competitive market player capable to protect interests of local business and foreign investors.



[136] UCC s. 9-609.
[137] *Id.* s. 9-610.
[138] It should be noted that "the equitable doctrine of marshaling via 1-103(b), sometimes can prevent a secured party from disposing of collateral. Disposing of an item of collateral generally harms other creditors in that they can no longer satisfy their claims from the item". *See* WARREN & WALT, *supra* note 13, at 287.
[139] UCC s. 9-620.
[140] WARREN & WALT, *supra* note 13, at 305.

# CHAPTER 2 - USING OF INVESTMENT PROPERTY AS COLLATERAL IN THE RUSSIAN FEDERATION

## *2.1 Russian secured transactions law*

It is impossible to find the Russian law (statute) that regulates all aspects of the any chosen activity. One always needs to examine, at least, several different laws in order to find all relevant rules. Russian secured transaction law is not an exception. There is no such thing in Russian Law as a functional approach; therefore, "the rule of law [is] contained in various statutes and regulations."[141]

The main set of rules which governs the secured transactions in Russia is contained in the Civil Code.[142] Chapter 23 of the Civil Code provides that "a transaction can be secured by the forfeit, pledge, retention of the debtor's property, surety, bank guarantee, and advance and also in the other ways stipulated by the law or by the agreement."[143] The phrase "in other ways stipulated by the law" is very common in Russian Law and means that there are enacted (or there will be enacted) federal laws which stipulate other ways of security of transactions not even described by the Civil Code. Consequently, it is not enough for the lawyer to examine only the Civil Code in order to determine whether the transaction in dispute is secured; it is necessary to examine bunch of different laws, what, in turn, does not contribute to the legal predictability and accessibility of the law. However, the Civil Code provides



[141] ALEXEI ZEVREV, EMERGING FINANCIAL MARKETS AND SECURED TRANSACTIONS 293 (Joseph J. Norton & Mads Andenas eds., Kluwer Law Int'l 1998).
[142] GRAZHDANSKIJ KODEKS ROSSIJSKOJ FEDERACII, CHAST' PERVAJA OT 30 NOJABRJA 1994 G. No, 51-FZ [Civil Code of the Russian Federation, First Part, No. 51-FZ of Nov. 30, 1994], SOBRANIE ZAKONODATEL'STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 1994, No. 32, Item 3301.
[143] Civil Code, *supra* note 142, art. 329.

general rules for secured transactions and any other law or Presidential or Government decree shall be adopted in conformity with it.[144]

The pledge, as a kind of security most relevant to this research, is also not governed only by the Civil Code. Its general rules are expanded by the Law of the Russian Federation on Pledge.[145] In case of using real property as collateral one also needs to examine Federal Law on Mortgage (Pledge on Real Estate).[146] In short, these statutes are the main sources of law on pledge. Nevertheless, some provisions important for secured transactions can be found in other statutes. For example, article 27.3 of the Federal Law on Securities Market contains rules for debenture bonds secured by pledge,[147] the Civil Procedure Code[148] regulates issues on enforcement; and rules on transactions with joint stock companies or limited liability companies can be found in the Federal Law on Joint Stock Companies[149] and the Federal Law on Limited Liability Companies[150] respectively.

This situation does not contribute to the accessibility and legal predictability of the secured transactions law in Russia, which, in turn may not allow the parties of secured transactions to fully realize and protect their rights. For solving this problem it is necessary to

[144] *See* Civil Code, *supra* note 142, art. 3.
[145] Zakon Rossijskoj Federacii No. 2872-1 o Zaloge ot 29 maja 1992 g. [Law of the Russian Federation No. 2872-1 on Pledge of May 29, 1992], Rossijskaja Gazeta [Russian Newspaper], 1992, No. 129.
[146] Federal'nyj Zakon No. 102-FZ ob Ipoteke (Zaloge Nedvizhimosti) от 16 ijulja 1998 g. [Federal Law No. 102-FZ on Mortgage (Pledge on Real Estate) of July 16, 1998], SOBRANIE ZAKONODATEL"STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 1998, No. 29, Item 3400.
[147] Federal'nyj Zakon No. 39-FZ o Rynke Cennyh Bumag ot 22 aprelja 1996 g. [Federal Law No. 39-FZ on Securities Market of Apr. 22, 1996], SOBRANIE ZAKONODATEL"STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 1996, No. 17, Item 1918.
[148] GRAZHDANSKIJ PROCESSUAL'NYJ KODEKS ROSSIJSKOJ FEDERACII No. 138-FZ ot 14 nojabrja 2002 g. [Civil Procedure Code No. 138-FZ of Nov. 14 2002], SOBRANIE ZAKONODATEL"STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 2002, No. 46, Item 4532.
[149] Federal'nyj Zakon No. 208-FZ ob Akcionernyh Obshhestvah ot 26 dekabrja 1995 g. [Federal Law No. 208-FZ on Joint Stock Companies of Dec. 26, 1995], SOBRANIE ZAKONODATEL"STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 1996, No. 1, Item 1.
[150] Federal'nyj Zakon No. 14-FZ ob Obshhestvah s Ogranichennoj Otvetstvennost'ju ot 8 fevralja1998 g. [Federal Law No. 14-FZ on Limited Liability Companies of Feb. 8, 1998], SOBRANIE ZAKONODATEL"STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 1998, No. 7, Item 785.

transfer all provisions on secured transaction at the existed Law on Pledge and forbid establishment of relevant rules by other laws.

## *2.2 Concept of "investment property" in Russian Law*

In contrast to the United States, there is no such term as "investment property" in Russian Law. Moreover, the Civil Code does not even contain the term of "investments" and, especially, "security investments." There can only be found the definition of "securities" which is much broader than the term in the UCC. However, it is still possible to talk about some similarities between UCC and Russian approaches.

### 2.2.1 Securities as collateral

In order to determine whether the category of "investment property," at least in part, is applicable in Russia, it is necessary to find out, whether securities, as a corner stone of investment property, can be used as collateral according to the Russian Law.

According to Civil Code article 336 "the subject of pledge shall be *any property, including the things and the property rights*, with the exception of the property, withdrawn from the circulation, of the claims, inseparably linked with the creditor's personality."[151]

Consequently, all types of property can be used as collateral but article 4(2) of the Federal Law on Pledge especially establishes the securities as the possible subject of



[151] Civil Code, *supra* note 142, art. 336.

pledge.[152] Therefore, it is useful to determine whether the category of "security" has the same meaning both in the US and Russia.

### 2.2.2 Security

The security is defined in the Civil Code as "a document confirming, with the observance of the established form and obligatory requisites, the property rights, whose exercising or transfer shall be possible only upon its presentation."[153] Such a broad definition is complemented by a list of kinds of securities provided in Civil Code article 143: "the government bond, the bond, the promissory note, the cheque, the deposit and the savings certificates, the savings-bank book to bearer, the bill of lading, the share, the privatization securities and also the other documents, which have been referred to the securities by the laws on the securities."[154] Consequently, it is not an exhaustive list of kinds of securities and, as was mentioned above, other laws can define another kind of security.[155] Securities can also be represented by a certificate in bearer or registered form (however, as mentioned below, it is different with investments securities).

As was mentioned above, the Civil Code does not make any distinction between "securities" and "investment securities." However, article 3 of RSFSR Law on Investment Activity in the RSFSR states that "*securities are objects of investment activity in the*



[152] It should be noted that there is the serious discussion in Russian legal theory what exactly the subject of the pledge is: the security, property right provided by it or both. *See* ZINOVIEVA & GVOZDEV, *supra* note 1, at 212; *See* GRAZHDANSKOE PRAVO: V 2 T. TOM II. POLUTOM 1 [Civil Law: In Two Volumes. Volume I. Semi-volume 1] at 105 (E.A. Suhanov ed., 2nd ed. Izdatel'stvo BEK 2000) for discussion on this issue.
[153] Civil Code, *supra* note 142, art. 142.
[154] Civil Code, *supra* note 142, art. 143.
[155] *See*, for example, Federal'nyj Zakon No. 152-FZ ob Ipotechnyh Cennyh Bumagah ot 11 nojabrja 2003 g. [Federal Law No. 152-FZ on Hypothecary Securities of Nov. 11, 2003], SOBRANIE ZAKONODATEL"STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 2003, No. 46 (Vol. 2), Item 4448; Federal'nyj Zakon No. 156-FZ ob Investicionnyh Fondah ot 29 nojabrja 2001 g. [Article 14 of Federal Law No. 156-FZ on Investment Funds of Nov. 29, 2001], art. 14, SOBRANIE ZAKONODATEL"STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 2001, No. 49, Item 4562.

*RSFSR*."[156] Moreover, according to article 1 of the Federal Law on Investment Activity in the Russian Federation which is Carried out in the form of Capital Investments, "'investments' are monetary funds, *securities* and other property, including property rights, other rights having monetary value, invested in business and (or) other activity for profit and (or) achieving another useful effect."[157] Consequently, despite lack of relevant provisions in the Civil Code, according to the Russian legislation, *securities are investments*.

Nevertheless, it is not correct to call all securities as *investment securities*. One needs to distinguish investment securities (shares, bonds and alike), documents of title (bills of lading, warrants) and negotiable instruments (cheques and promissory notes) because investment securities, as means of income generation, are called upon to support the stock market. Hence, they are also called as *stock securities* or *issued securities*.[158] Such securities are divisible and traded on securities markets and exchanges.[159]

It is not accidental that the term "investment security" can be met both in Russian and United States legislation because it is exactly from the UCC that the Russian legislatures found their inspiration, consequently, "concepts of investment securities in the law of the United States and in the theory of law of the Russian securities have a lot in common."[160] Notwithstanding, this worth mentioning that according to the Russian Law even non-issued

[156] Zakon RSFSR No. 1488-1 ob Investicionnoj Dejatel'nosti v RSFSR ot 26 ijunja 1991 g. [RSFSR Law No. 1488-1 on Investment Activity in the RSFSR of June 26, 1991], Bjulleten' Normativnyh Aktov [Bulletin of Normative Acts], 1992, No. 2-3.

[157] Federal'nyj Zakon No. 39-FZ ob Investicionnoj Dejatel'nosti v Rossijskoj Federacii, Osushhestvljaemoj v Forme Kapital'nyh Vlozhenij ot 25 fevralja 1999 g. [Federal Law No. 39-FZ on Investment Activity in the Russian Federation which is Carried out in the Form of Capital Investments of Feb. 25, 1999], SOBRANIE ZAKONODATEL"STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 1999, No. 9, Item 1096.

[158] *See* Federal Law on Securities Market, *supra* note 147, art. 2, according to which an "issued security" is any security, including non-documentary, which is marked by the following features: (a) establishes a set of property and non- property rights, subject to certification, assignment and unconditional implementation of the form and order established by the Federal Law on Securities Market; (b) placed by the issue; (c) has an equal amount and timing of the rights within the same issue, regardless of the time of purchase of the security.

[159] GRAZHDANSKOE PRAVO: V 2 T. TOM I [Civil Law: In Two Volumes. Volume I] at 320 (E.A. Suhanov ed., 2nd ed. Izdatel'stvo BEK 2000).

[160] E.V. AGAPEEVA, PRAVOVOE REGULIROVANIE RYNKA CENNYH BUMAG V ROSSII I SSHA [Legal Regulation of the Securities Market in Russia and USA] 19 (JUNITI-DANA 2004) [translation by author].

(and even not of a type) securities such as hypothecary securities or investment units can be considered as investment securities.

Therefore, despite differences in definitions, it is possible to say that investment securities under UCC Article 8 and investment securities under Russian Law are very close.

### 2.2.3 Uncertificated security

The category of "uncertificated security" also came to the Russian legal system from UCC Article 8.[161] However, while in the US most of issued securities are still certificated, in Russia *vice versa* almost all securities are issued in uncertificated form[162] which can be explained by mandatory rules on issuing certain types of security only on certificated or uncertificated form. Thus, according to article 16 of the Federal Law on Securities Market registered securities may be issued only in book-entry (uncertificated) form, except as provided by federal law, while bearer securities can be issued only in certificated form.[163]

According to article 2 of the Federal Law on Securities Market "uncertificated form of securities is a form of issued securities in which the owner is specified on the base of an entry in the register of holders of the securities or, in the case of deposit of securities, on the basis of an entry in the securities account."[164]

At first sight, the Russian definition is similar the definition in the UCC; nevertheless, there is a serious difference. UCC Article 8 treats uncertificated securities just like certificated



[161] GRAZHDANSKOE PRAVO: V 2 T. TOM I, *supra* note 159, at 321.
[162] L.R. JULDASHBAEVA, PRAVOVOE REGULIROVANIE OBOROTA JEMISSIONNYH CENNYH BUMAG (Akcij, Obligacij) [Legal Regulation of Issued Securities Sales (Stocks, Obligations)] 35 (Statut 1999).
[163] *See* V.A. ERSHOV, RYNOK CENNYH BUMAG: JURIDICHESKIJ SPRAVOCHNIK [Securities Market: Legal Guide] 2 (GrossMedia :ROSBUH 2009).
[164] Federal Law on Securities Market, *supra* note 147, art. 2.

ones, while in Russia it is important to remember about differences between "things"[165] and property rights because method of protection of holder's rights depends on type of property. It is clear that certificated securities are things because they are represented by a piece of paper but uncertificated securities cannot be treated in the same way. Therefore, uncertificated securities "can become subject of pledge only as a property right"[166] and not as a certificated security, which is a thing. However, uncertificated securities are also a little bit different from property rights, because operations with uncertificated securities may be made only with referring to the person performing the official record of rights. Thus, mandatory obligation to refer to persons officially committing records distinguishes pledge of uncertificated securities from pledge of property rights.[167]

Russian legislation does not give a solid answer as to whether the uncertificated securities shall be treated as a fictional "things" or property rights; consequently, there is no consensus between scholars.[168] And therefore, it is not clear what uncertificated securities are. Such a situation should be changed by amendment of Russian Laws either in the way of treatment of uncertificated securities as immaterial things with the same rights and possibilities for their holders as for certificated securities, or in another way – moving them out from certificated securities to property rights. It seems that first approach would be more favorable for market and investors as providing more legal predictability.



[165] According to the Russian civil law "things" are material objects like cars or certificated securities. *See* GRAZHDANSKOE PRAVO. UCHBENIK. TOM 1 [Civil Law. Text Book. Volume 1] at 254 (A.P. Sergeev & Ju.K. Tolstoj eds., 6th ed. Prospekt 2005) for explanation of the conception of "things."

[166] BRAGINSKIJ & VITRJANSKIJ, *supra* note 2, at 517.

[167] GRAZHDANSKOE PRAVO: V 2 T. TOM II. POLUTOM 1, *supra* note 152, at 105.

[168] *Cf.* GRAZHDANSKOE PRAVO: V 2 T. TOM I, *supra* note 159, at 321; V.A. BELOV, BEZDOKUMENTARNYE CENNYE BUMAGI. NAUCHNO-PRAKTICHESKIJ OCHERK [Uncertificated Securities. Scientific and Practical Essay] 14 (JurInfoR 2001) for arguments in favor of considering the uncertificated securities as property rights; and D.V. MURZIN, CENNYE BUMAGI - BESTELESNYE VESHHI [Securities – Immaterial Things] 78 (Statut 1998); G.N. Shevchenko, *Dokumentarnye i Bezdokumentarnye Cennye Bumagi v Sovremennom Grazhdanskom Prave* [Certificated and Uncertificated Securities in Contemporary Civil Law], 9 ZHURNAL ROSSIJSKOGO PRAVA [Russian Law Journal] 34 (2004) for opposite arguments.

### 2.2.4 Security entitlements and securities accounts

As stated above, the drafters of Russian securities law took a lot from the UCC Article 8; however, the situation is different for such categories as "security entitlement" and "securities account."

The Russian indirect-holding system is close to the system in the US. There are broker firms and nominee holders of securities but there is no such category as "security entitlement." Even when the securities are held through a nominee holder (indirect holding), the beneficial owner still owns securities and not property rights in interest as in the US. Moreover, the nominee holder in Russia does not have any rights of owner in respect of security. It is just a holder and nothing more; its main function is to keep tab on securities for the beneficial owner.[169] Consequently, even indirectly held security is treated like security and in case of secured transaction a security interest will be created not in "security entitlement" but in the security.

The situation with "securities accounts" is similar. There are securities accounts in Russian securities law, and when the securities are held indirectly, they are held in the securities accounts; however, it is impossible to create a security interest in the securities account, only in all securities held in the account. Thus, according to the Order of Accounting of the Pledge of Inscribed Issued Securities in the Register of Security Holders and Introduction of Modifications in the Register Concerning the Transfer of Rights on Pledged Registered Issued Securities approved by the Federal Financial Markets Service instead of



[169] *See* D.I. Stepanov, *Nominal'nyj Derzhatel' i Uchetnaja Sistema na Rynke Cennyh Bumag,* [Nominee Holder and Books of Records at Securities Market] TEORIJA I PRAKTIKA ORGANIZACII UCHETA PRAV SOBSTVENNOSTI NA IMENNYE CENNYE BUMAGI . SBORNIK NAUCHNYH TRUDOV, POSVJASHHENNYJ 10-LETIJU PRINJATIJA POSTANOVLENIJ FKCB NO. 27 I NO. 36 [Theory and Practice of Organization of Books of Records of Ownership Rights in Registered Securities. Collection of Scientific Papers Dedicated to the 10-Years Anniversary of Adoption of the Federal Commission for the Securities Market Decrees No. 27 and 36] 94, 108 (2007); N.Ju. Erpyleva & M.N. Klevchenkova, *Kollizionnoe i Material'noe Regulirovanie Obrashhenija Cennyh Bumag: Chastnopravovye Aspekty,* [Conflicts and Material Regulation of Securities Circulation: Private Law Aspects] 6 ZAKONODATEL"STVO I JEKONOMIKA [Legislation and Economics] 52, 57 (2009).

specifying the number of pledged securities in the collateral order, it can be specified that all securities (or all securities of certain kind, category (type), series) recorded on the personal account of a the pledger are pledged.[170]

### 2.2.5 Commodity contracts and commodity accounts

In contrast to UCC Article 9, Russian Law does not define the category "commodity contract," moreover, it is impossible to find any definition of "futures contract," "option contract" or "forward contracts." The only conclusion can be made that such commodity contracts are not securities.[171] For example, in Tax Code article 256(2) futures, option and forward contracts are defined as financial instruments of future transactions and listed after securities but not with them.[172]

There is no clear answer in the Russian legislation on the nature of commodity contracts but it seems that such contracts cannot be considered as independent objects of Civil Law. According to Russian legal theory such contracts are only types of contracts and it is impossible to create a security interest in such objects. However, it is possible to create a security interest in property rights of a commodity contract party. Nevertheless, there are no special provisions on creation or perfection of such security interest; therefore, general rules shall apply. It is clear that relevant rules are necessary and the Civil Code should be complemented with the rules on what exactly commodity contracts are.



[170] Porjadok Ucheta v Reestre Vladel'cev Cennyh Bumag Zaloga Imennyh Jemissionnyh Cennyh Bumag i Vnesenija v Reestr Izmenenij, Kasajushhihsja Perehoda Prav na Zalozhennye Imennye Jemissionnye Cennye Bumagi, Utverzhden Prikazom FSFR Rossii No. 12-52/pz-n ot 28 ijunja 2012 g. (Order of Accounting of the Pledge of Inscribed Issued Securities in the Register of Security Holders and Introduction of Modifications in the Register Concerning the Transfer of Rights on Pledged Registered Issued Securities approved by the Federal Financial Markets Service Decree No. 12-52/pz-n of Jun. 28, 2012), SPS KONSLUTANTPLUS [Database ConsultantPlus], 2012.

[171] For discussion on whether futures contracts are securities, *see* O. Rohina, *Byt' F'juchersu Cennoj Bumagoj ili ne Byt'?*, [Is futures a security or not?] 1 HOZJAJSTVO I PRAVO [Economic and Law] 48 (1997).

[172] NALOGOVYJ KODEKS ROSSIJSKOJ FEDERACII, CHAST' VTORAJA OT 5 AVGUSTA 2000 G. NO. 117-FZ [Tax Code of the Russian Federation, Part 2, of Aug. 5, 2000 No. 117-FZ], SOBRANIE ZAKONODATEL'STVA ROSSIISKOI FEDERATSII [Russian Federation Collection of Legislation] 2000, No. 32, Item 3340.

Similarly with securities account one cannot create a security interest in commodity account, while, of course, it is possible to trade commodity contracts via an intermediary. Instead, security interests shall be created in all property rights of commodity contract party.

Taking all the aforesaid into consideration, the category of "investment property," as it is used in UCC, cannot be applied to Russian Law. However, with certain limitations and exception of security entitlements and securities accounts, the category of "investment securities" is the same.

It seems that there is no necessity to implement into the Russian legislation the category of "investment property" because at present issued securities and commodity contracts are too far from each other even despite similarity in trading on exchanges. These categories are treated according to the Russian law absolutely differently and considered as very distinct objects of law. Only if the commodity contracts are treated as issued securities, it will make sense to combine them. Additionally, there is no need to transplant the category of "security entitlement" because: (1) it is contrary to the Russian legal theory of unified things and property rights in them,[173] and (2) there is no market need in this category.



[173] *See* GRAZHDANSKOE PRAVO. UCHBENIK. TOM 1, *supra* note 165, at 395.

### *2.3 Creation and perfection of a security interest*

#### 2.3.1 Creation of a security interest in certificated securities

Both the Civil Code and the Law on Pledge provide only two grounds for the creation of a security interest in a certificated security: agreement and statute.[174] While the contract is the most common ground, in some cases a security interest can be created without parties' agreement. For example, according to Civil Code article 488(5) "unless otherwise stipulated by the agreement, [the securities] sold on credit from the time of [their] transfer to the buyer and to [their] payment shall be recognized as held in pledge by the seller for the guaranteed execution by the buyer of his duty to make payment."[175]

Consequently, the main condition for creation of a security interest is an agreement and the security interest is created from the moment of the conclusion of the agreement, however, when the security should be transferred the pledgee, the security interest is created since the transfer of the security, unless otherwise provided by the security agreement.[176]

Thus, the security agreement shall be made out in *written form* and, if the main agreement is made out in notarial form, the security agreement shall be notarized too. The non-observance of these rules shall entail the invalidity of the security agreement.[177]

Apart from the requirement on form of the security agreement there are also important requirements on its content. The security agreement shall contain "terms with specification of security and its estimate, substance and amount, and the term of discharging the obligation, secured against by the pledge."[178] It shall also contain the indication, in the custody of which

[174] Civil Code, *supra* note 142, art. 334(3), Law on Pledge, *supra* note 145, art. 3(1).
[175] Civil Code, *supra* note 142, art. 334(3),
[176] *Id*, *supra* note 142, art. 448(5).
[177] *Id*. art. 339(2), art. 339(4).
[178] *Id*. art. 339(1); *See also* Law on Pledge, *supra* note 145, art. 10(1).

party the pledged security is. It is not necessary to transfer the security to the pledgee, it can be retained by the pledger and transferred to the notarial or bank deposit.[179]

Therefore, it is strongly recommended to put all the required information in the agreement, however, terms and conditions of the pledge of securities individualizing its subject may be made by several interrelated documents signed by the parties.[180] The requirements on content of the security agreement are as important as requirements on form because in the absence in the security agreement of information, individually determine the pledged security the pledge agreement cannot be concluded,[181] moreover, if the parties fail to reach agreement on at least one of the above mentioned conditions or the condition is not in the contract, the security agreement cannot be concluded.[182]

It is important to not only identify pledged securities but also it is necessary to identify its value. Usually, parties are free to determine value of the pledged securities on their own will, however, in the case when the pledged securities are owned partly or in full by the Russian Federation, its subjects or municipal formations, the value of such securities shall be estimated by an independent appraiser.[183]

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[179] Civil Code, *supra* note 142, art. 338(4); Law on Pledge, *supra* note 145, art. 4(4).

[180] *See* Informacionnoe pis'mo Prezidiuma VAS RF No. 67 Obzor Praktiki Razreshenija Sporov, Svjazannyh s Primeneniem Norm o Dogovore o Zaloge i Inyh Obespechitel'nyh Sdelkah s Cennymi Bumagami ot 21 janvarja 2002 g. [Informational Letter of the Russian Federation Supreme Arbitrazh Court Presidium No. 67 of Jan. 21, 2002], art. 4, VESTNIK VYSSHEGO ARBITRAZHNOGO SUDA ROSSIJSKOJ FEDERACII [Bulletin of the Supreme Arbitration Court of the Russian Federation], 2002, No. 3.

[181] *See* Informacionnoe pis'mo Prezidiuma VAS RF No. 26 Obzor Praktiki Rassmotrenija Sporov, Svjazannyh s Primeneniem Arbitrazhnymi Sudami Norm Grazhdanskogo Kodeksa Rossijskoj Federacii o Zaloge ot 15 janvarja 1998 g. [Informational Letter of the Russian Federation Supreme Arbitrazh Court Presidium No. 26 "Review of the practice of settlement of disputes relating to the application of the rules of the Civil Code of the Russian Federation on the pledge by arbitrazh courts" of Jan. 15, 1998], art. 2, VESTNIK VYSSHEGO ARBITRAZHNOGO SUDA ROSSIJSKOJ FEDERACII [Bulletin of the Supreme Arbitration Court of the Russian Federation], 1998, No. 3.

[182] *See* Postanovlenije Plenuma Verhovnogo Suda RF No. 6, Plenuma VAS RF No. 8 o Nekotoryh Voprosah, Svjazannyh s Primeneniem Chasti Pervoj Grazhdanskogo Kodeksa Rossijskoj Federacii ot 1 ijulja 1996 g. [Decree of the Plenum of the Russian Federation Supreme Court No. 6, Plenum of the Russian Federation Supreme Arbitrazh Court No. 8 of July 1, 1996], art. 43, VESTNIK VYSSHEGO ARBITRAZHNOGO SUDA ROSSIJSKOJ FEDERACII [Bulletin of the Supreme Arbitration Court of the Russian Federation], 1996, No. 9.

[183] *See* Federal'nyj zakon No. 135-FZ ob Ocenochnoj Dejatel'nosti v Rossijskoj Federacii ot 29 iiulja 1998 g. [Federal Law No. 135-FZ on Valuation Activities in the Russian Federation of July29, 1998], art. 8, SOBRANIE

The other important condition that must be contained in the security agreement is substance and amount, and the term of discharging the obligation, secured against by the pledge. If the pledger is the debtor, it is not necessary to copy all terms from the loan agreement, it is enough only to make a reference to this agreement, while if the pledger is not a debtor, he or she obviously may not have an access to loan agreement signed by the other parties, therefore, it is necessary to put into the pledge agreement all relevant terms of the secured obligation.[184]

Additionally, the Civil Code states that a security interest in a security can be created either by a debtor or by other party; while anyways the pledger shall be the owner of the security or has the right of economic jurisdiction over the security (however, owner's consent is still necessary in the latter case[185]).[186]

Finally, as far as a securing obligation is an accessory obligation, it is valid only when the secured obligation is valid and effective.[187] It means that for the securing obligation to be effective it is necessary that the secured obligation is also effective. For example, the loan agreement is effective when the loaned money is transferred to a borrower.[188]

To sum up, the security interest in the certificated security can be created when: (1) the secured obligation is effective; (2) the pledger is the owner of collateral or has the right of economic jurisdiction over the security; (3) the security agreement that provides a description of the collateral and met with other requirements for form and content is concluded; (4) or the certificate is delivered to the pledgee if the security agreement provides so. One may notice



ZAKONODATEL"STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation], 1998, No. 31, Item 3813.

[184] Decree of the Plenum of the Russian Federation Supreme Court No. 6, Plenum of the Russian Federation Supreme Arbitrazh Court No. 8, *supra* note 182, art. 43.

[185] Civil Code, *supra* note 142, art. 295(2).

[186] *See id.* chapter 19 for the definition and explanation of the "right of economic jurisdiction" concept.

[187] *Id.* art. 329(3).

[188] *Id.* art. 807(1).

that these requirements are very close to requirements contained in section 9-203 of UCC Article 9, however Russian requirements for creation of the security interest are stricter than in the UCC and better protect interests of both parties: the secured party is sure that the pledger has all rights in collateral or owner's approval, and both party express their will in the signed agreement which contains all necessary information about the collateral and secured obligation.

### 2.3.2 Creation of a security interest in uncertificated securities (fixation)

To create a security interest in an uncertificated security it is also necessary to sign the security agreement that met all the above mentioned requirements, as well as other requirements for valid secured obligation and rights of pledger in the collateral. However, while uncertificated securities are kinds of property rights according to Russian Law, the additional requirement for a valid security agreement shall be met: it is necessary to identify in the security agreement the person who has obligation to the pledger under the uncertificated security.[189]

Nevertheless, it is not enough just to conclude the security agreement for creation of the security interest in the uncertificated security. According to Civil Code article 149 and rulings of the Supreme Arbitrazh Court a security interest in uncertificated securities is created only after its fixation in the prescribed manner.[190]

The procedure of fixation is governed by the Order of Accounting of the Pledge of Inscribed Issued Securities in the Register of Security Holders and Introduction of



[189] Law on Pledge, *supra* note 145, art. 55.
[190] Informational Letter of the Russian Federation Supreme Arbitrazh Court Presidium No. 67, *supra* note 180, art. 13.

Modifications in the Register concerning the transfer of rights on pledged registered issued securities approved by the Federal Financial Markets Service.[191]

Fixation of the right of pledge shall be effected by making the entry about charge of pledged securities on the account of the pledger in which they are included. For recording information on pledge of securities (including the terms of pledge and subsequent pledge of securities) registrar opens in the register of registered securities account of the pledgee. Fixation is made on the basis of collateral orders signed by the pledger and the pledgee or their authorized representatives.

It is noteworthy that, just as the transfer of a security certificate to a secured party better protects its interests by preventing disposal of the security, transfer of an uncertificated security to the account of the secured party also may prevent redemption of securities without knowledge of the secured party.[192] Therefore, it is strongly recommended to the creditor to insist on such a transfer.

The above mentioned Order contains provisions on transfer of pledged securities as well as on what information a collateral order shall have, what information is indicated in the entry about charge of pledged securities, amendment of information in accounts of pledger and pledgee, transfer of pledged securities, making an entry about termination of pledge, hence, one needs to examine this Order for all issues relevant for creation of the security interest in the uncertificated securities.



[191] Order of Accounting of the Pledge of Inscribed Issued Securities in the Register of Security Holders and Introduction of Modifications in the Register Concerning the Transfer of Rights on Pledged Registered Issued Securities, *supra* note 170.

[192] Tat'jana Majorova, *Zalog Bezdokumentarnyh Cennyh Bumag. Kakie Riski Podsteregajut Kreditora, Kak Mozhno Ih Izbezhat' ili Minimizirovat'* [Pledge of Uncertificated Securities. What risks await a creditor and how to avoid or minimize them], 4 JURIST KOMPANII [Company Lawyer] 32, 33 (2008).

### 2.3.2 Perfection

Unlike UCC Article 9 approach, a security interest in a security is perfected automatically upon its creation. In other words, there is no division on attachment and perfection. When a security agreement is concluded, or a certificate is transferred to a pledgee, or a security interest in an uncertificated security is fixed, it is enforceable not only against a debtor but against all other creditors. The concept of "perfection," as well as concept of "control" is unknown in Russian Law, and, therefore, there are no requirements for filing and no such possibility because of lack of special offices.

Though, Russian legislature did not forget about the possibility and adverse effect of secret liens, and established the obligation for all legal entities and entrepreneurs to maintain a special pledge registry which shall be presented to anyone at short notice.[193] The pledger is responsible for timely and correct making of entry to the pledge registry, and must compensate the affected party for all losses caused by untimely, incomplete or inaccurate entries in the registry, and the evasion of the obligation to make entry about a pledge.

In theory, such a provision should provide the opportunity for all parties witch interest to obtain information about property of a company, whether it is pledged or free from all encumbrances. However, absence of an effective mechanism for compulsion a pledger to maintain the registry makes this obligation, in fact, non-working.

In fact, only the creation of the security interest in uncertificated securities creates sufficient public notice because all pledges are fixed in special registry, while with certificated securities, especially in bearer form, it is almost impossible to obtain information about existing security interests. As the result, such situation "creates a lot of problems in

[193] Law on Pledge, *supra* note 145, art. 18(1).

identifying which creditor has a priority, especially in cases when the [parties] acting not in a good faith sign pledge agreements with old dates."[194]

While there is no need to artificially divide the process of formation of a security interest into attachment and perfection, it seems necessary to borrow from the UCC necessity to provide a sufficient public notice in the case of certificated securities when they are not transferred to a pledgee.

### *2.5 Priority rules*

The pledged security maybe repledged several times, if the initial security agreements provides so (additionally, the debtor must notify all subsequent pledgees about all previous pledges over the security).[195] Thus, it is possible that several secured parties will have a security interest in the security. Therefore, it is necessary to understand whose security interest has priority.

Priority of the secured creditor in Russia depends on the time of the security interest creation. According to the Civil Code, "if the pledged security becomes the object of yet another pledge as a security against other claims (the subsequent pledge), the claims of the subsequent secured creditor shall be satisfied from the cost of this security after the claims of the previous secured creditor."[196]

Therefore, if several creditors secured their claims and created the security interest in the security, the first in time secured creditor is first in rights. However, it is possible that the subsequent secured party tries to enforce its security interest before the first in time creditor.

[194] *See* ZINOVIEVA & GVOZDEV, *supra* note 1, at 213.
[195] Civil Code, *supra* note 142, art. 342(1).
[196] *Id.*

In this case, the first in time creditor may also enforce the security interest even, if according to the secured obligation, the payment due date does not come; consequently claims of the subsequent secured creditor will be satisfied only after claims of the first in time creditor. It should be noted, that if the first in time secured party failed to enforce its security interest along with the subsequent creditor, the security interest of the first in time creditor survives the disposal of the collateral, and its purchaser (if neither knows nor should have known that he or she acquired the security that is subject to the pledge) buys the security with security interest in it.[197] Additionally, as well as in the US, the security interest of the secured party has priority over all claims of other creditors.[198]

It may be concluded that Russian priority rules are close to the US in conception "first-in-time-first-in-right", while there is no special priority for intermediaries. And it seems that it is not necessary to add such priority rules, because in the case of uncertificated securities, the security interest is attached only upon fixation of the pledge right in the registry, therefore, the intermediary knows immediately whether there is a security interest. Consequently, the intermediary may refuse to be a consequent pledgee and ask for another property as collateral.



### *2.6 Enforcement*

The procedure of enforcement of the security interest can be for the purpose of discussion divided into two stages:

1. Commencement of the procedure of enforcement;

[197] Civil Code, *supra* note 142, art. 342(4).
[198] *Id.* art. 334(1).

2. Realization of the collateral with distribution of profit.[199]

Commencement of the procedure of enforcement. In the case of default the secured creditor has two options how to enforce the security interest in the collateral: with and without involvement of a court, however, out-of-court enforcement is possible only if the security agreement provides so and (1) if the pledged security is not the subject of previous or subsequent pledge with different methods of enforcement, and (2) if the security is pledged by several pledgers.[200]

It is important to remember that in Russia courts' jurisdiction depends on the parties of the agreement. If the parties (or one of them) are private persons, the lawsuit for foreclosure should be filed to a trial court of general jurisdiction, and the procedure will be governed by the Civil Procedure Code.[201] On the other hand, if the parties are legal entities or sole proprietors, the lawsuit should be filed to an arbitrazh court, and the procedure will be governed by the Arbitrazh-Procedure Code.[202]

After the awarding judgment and issuing of warrant of execution, the pledgee may start the process of realization of the collateral with the Court Bailiffs Service.

In the case of out-of-court enforcement the secured party shall send to the pledger a notification on commencement of the enforcement procedure with indication of the title of the pledged security, sum of debt, method of realization of security and the price of the security.[203] Additionally, in the case of notary certificated security agreement it is possible to commence the enforcement procedure by applying to a notary for the enforcement



[199] *See* Poskrebnev, *supra* note 5.
[200] Civil Code, *supra* note 142, art. 349(1), art. 349(3).
[201] Civil Procedure Code, *supra* note 148.
[202] ARBITRAZHNYJ PROCESSUAL'NYJ KODEKS ROSSIJSKOJ FEDERACII OT 24 IJULJA 2002 G. NO. 95-FZ [Arbitrazh-Procedure Code of the Russian Federation No. 95-FZ of July 24, 2002], SOBRANIE ZAKONODATEL'STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation] 2002, No. 30, Item 3012.
[203] Law on Pledge, *supra* note 145, art. 24.1(2).

inscription.[204] Such enforcement inscription is sufficient ground for the Court Bailiffs Service to commence realization of the collateral.

Realization of the collateral. If the parties opt for the court procedure or making of the enforcement inscription by the notary, the realization of the collateral is made by the Court Bailiffs Service on the ground of the pledgee's motion at public sale at the securities exchange[205] in accordance with the provisions of the Federal Law on Enforcement Proceedings.[206] If the pledgee does not file the motion on realization of the collateral to the Court Bailiffs Service, bailiffs seize the security and transfer it to the pledgee for realization without public sale.

Additionally, if the parties are legal entities or sole proprietors it is possible for them to agree on such provisions, that the pledgee in the case of default has the right to sale the collateral without public sale (include without limitation to through a commission agent) or accept it in full or partial satisfaction of the obligation or (strict foreclosure).[207] The latter provision entered Russian Law in 2009 and made it easier to the secured creditors to protect their interest and quickly receive satisfaction in case of debtor's default.[208] Therefore, possibility of strict foreclosure made Russian rules as much effective as US rules, it is much cheaper and faster to accept the collateral it in full or partial satisfaction of the obligation or



[204] Civil Code, *supra* note 142, art. 349(6); the procedure of making of the enforcement inscription is governed by Osnovy Zakonodatel'stva Rossijskoj Federacii o Notariate, Utverzhdennye VS RF ot 11 fevralja 1993 g. No. 4462-1 [Basics of the Russian Federation legislation on Notaries approved by the Supreme Court of the Russian Federation No. 4462-1 of Feb. 11, 1993], Rossijskaja Gazeta [Russian Newspaper], 1993, No. 49.
[205] Law on Pledge, *supra* note 145, art. 28.1(2).
[206] Federal'nyj Zakon RF No. 229-FZ ob Ispolnitel'nom Proizvodstve ot 02 oktjabrja 2007 g. [Federal Law of the Russian Federation No. 229-FZ on Enforcement Proceedings of Oct. 2, 2001], SOBRANIE ZAKONODATEL'STVA ROSSIJSKOJ FEDERACII [Russian Federation Collection of Legislation] 2007, No. 41, Item 4849.
[207] Law on Pledge, *supra* note 145, art. 28.1(3).
[208] *See* Aleksandr Korshunov, *Obratit' Vzyskanie na Predmet Zaloga Stalo Proshhe. Kakim Obrazom Kreditory Smogut Ispol'zovat' Novye Pravila s Maksimal'noj Vygodoj* [To Foreclose Collateral has Become Easier. How the Creditors Can Use the New Rules to the Maximum Benefit], 3 JURIST KOMPANII (Company Lawyer) 22, 23 (2009).

sell it to any third party (even through a commission agent) than wait when the Court Bailiffs Service organizes the public sale.

# CONCLUSION

This thesis analyzed what exactly investment property is according to UCC Articles 8 and 9, how a security interest in investment property is created and perfected, what priority have secured creditors who perfected their security interest and how the priority changes depending on method of perfection, and what methods of enforcement of the security interest. As the result of this analysis it can be states that the UCC approach to the regulation of secured transactions is highly comprehensive, sophisticated and orientated to the market needs.

On the other hand, Russian legislation on using investment securities as collateral is not so elaborated and detailed. The first thing that can be noticed is the absence of a functional approach. Secured transactions are regulated by different statutes and regulations, and it is impossible to quickly find rules relevant to a particular transaction. Taking into account differences of legal systems and approach, it is still strongly recommended to the Russian legislature to amend the already existing Law on Pledge, move there relevant provision from the Civil Code and forbid establishment of rules on transactions secured by pledge by other federal laws and regulations. Moreover, it is recommended to amend the notion of securities, and especially, uncertificated securities in order to eliminate the misunderstanding concerning the nature of the uncertificated securities. It is necessary to treat certificated and uncertificated securities in the same manner, as it is done by the UCC.

Additionally, the Law on Pledge should be amended in the manner providing possibility for the secured party to make a public notice about pledged property. It can be made by three methods: (1) establishment of the filing office analogous to the US with making of the security interest enforceable even against the debtor only after filing; or (2) requirement of mandatory transfer of pledged security to a pledgee or depository; or (3)

combining previous suggestions by making the security enforceable even against the debtor either after filing or transfer the certificated to the pledgee or depository. Such procedures may help to prevent possible actions in bad faith by the debtor and (or) pledger and can give sufficient public notice to the public. However, it does not seem necessary to artificially divide procedure of creation of the enforceable security interest into two stages: attachment and perfection, since it can only make rules more complex.

Finally, the Civil Code should be amended in a manner that provides a definition and description of the category of "commodity contract." Such contracts are actively used on Russian markets and the lack of relevant provisions in the legislation harms the market and does not contribute to legal predictability of the law. Nevertheless, there is no need to unite categories of "investment securities" or "issued securities" with "commodity contracts", because despite of similarity in trading practices, such categories are considered by the Russian Law as absolutely different categories. The abovementioned changes in Russian secured transactions law can benefit current market practices, which, in turn, can lead to growth of the economy.

It should be noted, that not all UCC categories are applicable to Russian Law. For example, there is no need to add the category of "security entitlement" since it is contrary to Russian legal theory to divide property and property rights. The existing approach of treating beneficial owners as full power owners, and nominal holders as holders and nothing more is proved to be effective and does not need to be changed. The same with "securities account", it is possible to pledge all securities hold at the account, and there is no necessity to make securities account distinct object of the law. Moreover, requirements for creation of the security interest according to the Russian Law can be considered as even more protective for both parties than the same provisions in the US.

Taking all the aforesaid into consideration, the suggested changes may benefit the existing situation in Russia; make the market "safer" and the law more predictable, which, in turn, will make Russia a strong and competent player on the international market open to foreign investments.

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