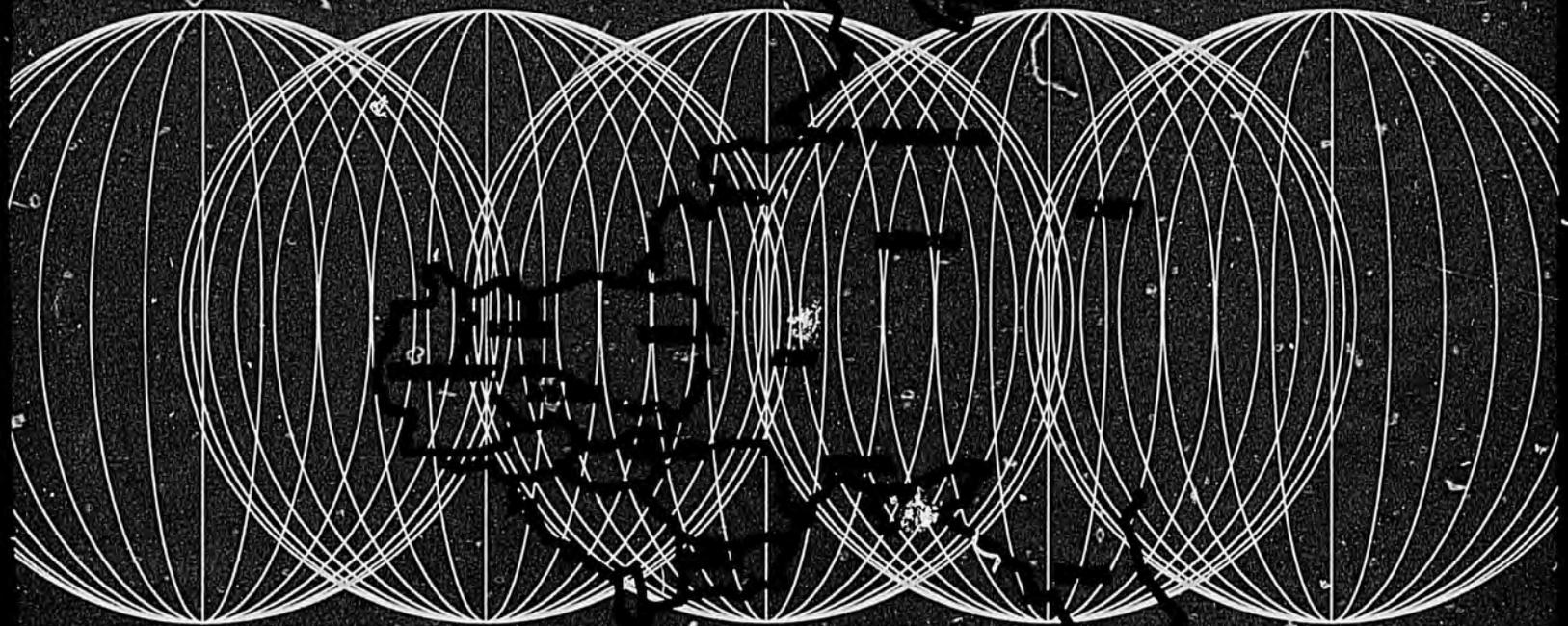
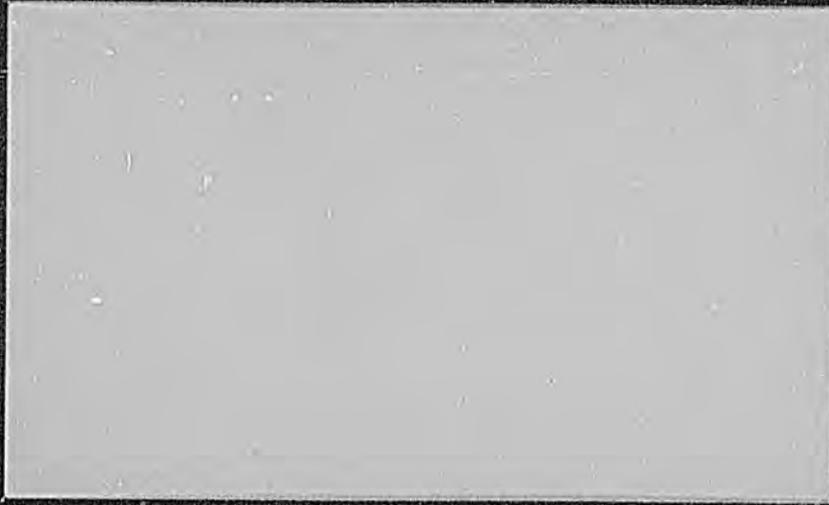


**FROM PLANNING TO MARKETS
HOUSING IN EASTERN EUROPE**



THE URBAN INSTITUTE
Prepared for the Office of Housing and Urban Programs (USAID)

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**THE LEGAL BASIS FOR
RESIDENTIAL MORTGAGE
LENDING IN THE RUSSIAN FEDERATION**

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ABSTRACT

The move toward a private housing sector in the Russian Federation may depend in significant part on the growth of private mortgage lending. At this time the prices of new and existing housing in the Russian Federation is well beyond the savings of average Russian families.

As part of its long term advisory mission in housing and urban development to the governments of the Russian Federation and the City of Moscow, consultants for the United States Agency for International Development Shelter Sector Reform Project have been working with several Russian banks to develop legal, economic and management concepts and procedures for initiation of a residential mortgage banking industry. This paper was prepared as the first step in a longer process of addressing the shortcomings, if any, in the existing Russian laws governing secured real estate finance. The primary purpose of this paper is to provide USAID's Russian clients with a basis for comparing their own laws with those of the United States, which has a successful and efficient system of residential mortgage lending.

In Section I this paper examines the existing law of the Russian Federation affecting residential mortgage financing, including The Fundamentals of Civil Legislation (1992), the Civil Code (1961, as amended), The Law on Pledge (1992) and the Law of Civil Procedure (1961, as amended). Legal issues under other Russian laws are discussed to the extent that they affect mortgage lending.

Section II provides a critical analysis of the existing Russian law in comparison to the law of the United States. To some extent, the analysis follows the Uniform Land Security Interest Act, a model act promulgated by the United States Commissioners on Uniform State Laws in an attempt to rationalize the mortgage law of the United States.

The approach of the analysis is to identify areas that increase the transaction costs or risks of mortgage lending, the premise being that increasing such costs and risks will result in higher costs of borrowing, less lending, or both. Suggestions are made for protection of debtors that emphasize disclosure, notice and rights of cure.

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EXECUTIVE SUMMARY

With the enactment of the 1992 Law on the Privatization of the Housing Stock, the Russian Federation began a gradual conversion of the housing sector to private market principles. In the sphere of existing housing, several million apartment units have been transferred to the ownership of their occupants, and a recent estimate states that fully 1/3 of the housing in Moscow is now in private hands.

While the existing housing is being transferred at no cost to the occupants, to encourage the creation of an active housing market and sorely needed new production, a private mortgage lending industry will probably be necessary. This will be unfamiliar territory for Russia, where loans to individuals for purchase or construction of residential property are virtually non-existent or, if they do exist are usually secured by personal guarantees and not real estate.

The existing Russian civil laws and laws of civil procedure do provide for residential mortgage lending and enforcement of liens on real estate, but they are characterized by ambiguity. The earlier laws clearly do not anticipate a significant level of private mortgage lending. More recent Russian laws dealing specifically with secured financing, including the 1992 Law on Pledge and a Law on Mortgages that is pending as of this writing, clarify some issues but confuse others. In many instances, all of the laws, even the most recent, contain provisions that unnecessarily increase the transaction costs and risks of mortgage lending.

This paper does not provide a detailed analysis of the many differences between the Russian law and the law of the United States, but rather sets out major areas for consideration. These areas include, for example, the following:

- The existing law limits mortgage enforcement procedures to foreclosure by action and court supervised auction sale; other procedures, including sale by private action and deeds in lieu of foreclosure may be appropriate in defined circumstances and bring more efficiency to the system.

- Certain unsecured creditors or obligations appear to have legal priority over registered mortgage, regardless of when the obligations arose. Several of these priorities are vague, and all are unregistered, causing significant issues in both the underwriting and enforcement stages of mortgage lending.

- Courts in the Russian federation have broad and largely undefined discretion to redefine the terms of mortgage security, through mandatory forbearance or loan restructuring, based on the debtors circumstances.

The scope of this judicial power may need to be more clearly defined and constrained.

-- The effects of challenges and appeals on timely enforcement of security may need to be better defined.

-- The consequences of foreclosure with respect to the rights of third parties and bona fide purchasers of properties at foreclosure sale are ambiguous. The laws allow challenges to and nullification of completed foreclosure sales for considerable periods of time after completion. Such provisions could have a chilling effect on prices in foreclosure sale and the grounds for challenge and nullification may be better defined.

-- The laws on negotiability of financial instruments such as mortgage debts may need additional consideration to the extent that a secondary market in residential mortgages is to be encouraged; under the present economic circumstances in a country of Russia's size, secondary markets will probably be necessary.

The existing Russian laws would probably support a very limited private sector mortgage banking industry, but not without legal issues arising frequently. A more extensive mortgage lending system would require modification or clarification of many aspects of the existing law.

Russia is a code or civil law system, and has had little experience with private sector mortgage lending and the associated legal issues. For both reasons, it lacks the substantial body of interpretation, judicial or otherwise, that govern the many legal nuances arising in residential mortgage financing that simply may not be anticipated in written law. Since much of the success of a system of residential mortgage finance may depend on how the laws are interpreted and enforced, and also on the uniformity of interpretation throughout the national market, it is likely that promulgation of additional regulations, more detailed than the existing laws, will have to be considered.

**THE LEGAL BASIS FOR RESIDENTIAL MORTGAGE LENDING IN THE
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1

THE LEGAL BASIS FOR RESIDENTIAL MORTGAGE LENDING IN THE RUSSIAN FEDERATION

I. THE EXISTING LAW

A. INTRODUCTION

A.1. General Background

The Russian Federation has decided that housing should be privately owned.¹ A system in which as recently as three

¹ A good statement of this policy is found in the recently enacted Law of the Russian Federation On Basic Principles of Federal Housing Policy, December 24, 1992, which states in the preamble:

The goal of Federal Housing Policy is to ensure social guarantees for the right of citizens for housing; to accomplish construction and rehabilitation of state, municipal and private housing stock; to create conditions for attraction of non-budget sources of financing (financial resources of the population, enterprises, organizations, institutions, public associations, domestic and foreign entrepreneurs, bank credits and other sources); to develop private property; to protect entrepreneurs and owners rights in the housing sector; to promote competition in construction, repair and maintenance of the housing stock, manufacture of building materials, articles and goods to furnish houses. (Unofficial Translation)

See also Revised Draft of Government Reform Program, FBIS-USR-92-139, Oct. 30, 1992.

Comments in this paper on the condition of the Russian housing sector and directions of Russian housing policy are based upon the author's visits to Russia between August, 1992 and February, 1993, on behalf of The Urban Institute and the United States Agency for International Development, during which he provided consultation to various Ministries of the Russian Federation and the City of Moscow on restructuring the legal basis for housing and urban development.

The author wishes to thank Professor Alexander L. Makovsky of the Supreme Soviet Institute for Legislation and Comparative Law for his review of this paper and invaluable comments on the Russian law. The author takes full

years ago almost 80% of the urban housing stock was owned by the state or quasi-public institutions is undergoing a radical transformation by transfer of publicly owned housing assets into private hands. By mid 1992, for example, over 250,000 publicly owned apartment units in the City of Moscow had been transferred to occupants at little or no cost.

Along with private ownership, Russian policy seeks to promote the creation of private housing markets and induce new housing construction through "non-budgetary" means. Given the present economic constraints in Russia, it is unlikely that significant amounts of public funding will be available for housing finance or development in the coming years. This is not to say that there will be no government assistance for housing, as several types of housing subsidy programs -- including interest rate subsidies, housing allowances and direct downpayment grants -- are under active consideration. Most current discussions of housing assistance, however, view the government's role as supplementary to the primary role of the private sector in financing acquisition and development.

It is expected that privatization of existing housing will lead to the creation of housing markets and a more efficient allocation of housing assets, for example as those who presently occupy excess space seek to realize the value of their apartments by moving to accommodations of more suitable size. It is expected also that guarantees of ownership rights will encourage demand for and production of new housing.

Working against the privatization policy, there is a substantial disparity today between the price of housing, existing or newly constructed, and the average Russian family income. The average market price for an existing apartment in Moscow today is probably well over 2,000,000

responsibility for any errors of interpretation that remain in the discussion of existing Russian law and for the analysis and recommendations that follow.

roubles, or approximately 40 times the average yearly family income. The price/income disparity with respect to newly constructed housing is even greater. Moreover, the personal savings of Russian families have been severely eroded in the past year by the very high rate of inflation, leaving little to invest in housing. Consequently, a potentially significant barrier to the realization of private housing markets and new development is the lack of a Russian mortgage lending system.²

While residential mortgage lending is not entirely unknown in Russia, it is highly unusual. The private banking system is in an early stage of development and has little experience with originating and servicing residential mortgage loans. Private sector financial institutions also lack funds to initiate a large scale mortgage lending program and, given the generally low level of savings in Russia today, the pressing needs in other economic sectors and the relative inexperience with residential mortgage lending as an investment vehicle, mobilization of private investment for residential mortgage lending may be difficult.

Despite the obstacles, private ownership and development of housing is Russian policy. It may not be realized under current economic conditions without the gradual development of a private mortgage banking industry. It appears, then, that a corollary to the policy of housing

² Even though housing is being transferred to citizens at little or no cost, it is likely that some level of mortgage financing will be necessary. While housing privatization has provided a significant personal asset to a large number of individuals, the asset is not liquid. It is probable that many individuals desiring to "trade up" their newly acquired housing will not be able to do so if first-time buyers cannot obtain financing, or if financing is not available to supplement the difference in price between their present homes and larger existing or newly constructed homes. In the absence of mortgage financing the market may, therefore, stagnate.

privatization and private housing markets is the related policy of encouraging private investment in residential mortgage lending. The premise of this paper is that while achievement of housing policy objectives may not be assured through the enactment of appropriate laws, the lack of necessary legal infrastructure or the enactment of inadvisable laws could hinder the effort.³

A.2. Scope of this Paper

Under its mission to provide consultation to the Russian Federation and the City of Moscow on issues of housing privatization, finance and development, The Urban Institute has undertaken a review of existing law in the Federation in order to identify the legal barriers, if any, to creation of an efficient, financially sound, private sector residential mortgage lending industry.

This paper summarizes the existing laws in the Federation relevant to mortgage lending for residential property; analyzes the existing laws to determine where they depart significantly from the more established residential mortgage finance laws of the United States; and makes several recommendations for clarification or modification of the existing Federation laws that might result in a more efficient system.

The perspective of this paper is primarily that of a mortgage lender seeking to assess the costs and risks of originating and enforcing mortgage loans for existing

³ Perhaps the greatest impediment to the creation of a housing finance system in Russia today is not the law, but hyper-inflation. While many types of variable rate mortgage instruments have been devised in recent decades to protect the financial system against the ravages of inflation, and some of those have even proved effective in developing, high inflation economies, no system of housing finance can work effectively in the face of inflation rates exceeding 100% per annum. See Katherine Mark and Jeffrey P. Telgarsky, Alternative Mortgage Instruments in High Inflation Economies, Hous. Fin. Int'l (September, 1991).

residential properties. Not discussed in this paper, however, are basic issues of property rights in housing and land that may be relevant to residential mortgage lending.⁴ It is assumed that mortgages will be taken on such property rights as exist at the time.

Also not specifically addressed in this paper are the issues arising in various specialized types of residential mortgage lending, including construction lending for single and multifamily properties and mortgage loans for apartments in commonly owned buildings. To a large extent, however, many of the issues discussed in this paper are relevant to all types of secured real estate finance under Russian law.

B. BASIC LAWS

The basic laws of the Russian Federation affecting residential mortgage lending are (1) the Fundamentals of Civil Legislation of the USSR and the Republics, May 31, 1991, as amended (the "Fundamentals of Civil Legislation");⁵ (2) the Civil Code of the Russian Soviet Federative Socialist Republic ("RSFSR"), June 11, 1964, as amended (the "Civil Code");⁶ (3) the Law on Pledge of the Russian

⁴ The 1992 amendments to Articles 10 through 12 of the Russian Constitution seem to have resolved some issues of property rights in the housing sector. See Law on Changes and Amendments to the Basic Law (Constitution) of the Russian Federation, December, 1992. The amendment of Article 12 of the Constitution, for example, provides that land appurtenant to housing may be alienated by its owner in private market transactions, without restriction. However, the precise scope of the recent amendment of Article 12 is as yet unclear. For example, several lawyers for the City of Moscow with whom the author spoke took the position that the new constitutional amendment does not apply to residential land within municipalities, leaving unchanged, for example, property rights in land underlying multifamily buildings.

⁵ Translated in J. V. Dialogue, SovData Dialine, May 31, 1991.

⁶ The Soviet Codes of Law (William B. Simons ed. 1984).

Federation, May 29, 1992 (the "Law on Pledge");⁷ and (4) the Code of Civil Procedure of the RSFSR, June 11, 1964, as amended (the "Code of Civil Procedure").⁸

The Civil Code had since 1964 been the legal basis for private commercial transactions in the Federation. It addresses, in a rudimentary way, the pledge of interests in residential property. Together with the Code of Civil Procedure, it was also the basic Russian law dealing with the rights and obligations of domestic creditors and debtors under loan agreements.

In late 1991, the Supreme Soviet of the USSR promulgated the Fundamentals of Civil Legislation for the entire USSR, to become effective as of January 1, 1992, which turned out to be subsequent to the dissolution of the USSR. However, the Fundamentals of Civil Legislation was adopted by the Russian Supreme Soviet on July 14, 1992, effective as of August 3, 1992, as the fundamental civil law of Russia also. The Fundamentals of Civil Legislation establishes basic principles of civil law for Russia, but does not overturn consistent provisions of the existing Civil Code.

⁷ Unofficial Translation, The Urban Institute (1992).

¹² Trans. by A. K. R. Kiralfy in The Soviet Codes of Law (William B. Simons ed. 1984).

There are other laws dealing with the rights to own and pledge land and housing, most notably the Law on Ownership of the RSFSR (July 14, 1990) and the Land Code of the RSFSR (April 25, 1991). However, these laws focus on fundamental property rights in land and housing, and they address mortgage issues only incidentally.

For example, the Law of Ownership grants to citizens the right to own dwelling houses, dachas and apartments (Article 10) and to use owned property "as the subject of a pledge or encumber it by other means." (Article 2 (2)). Under that law citizens are also made liable for their obligations "with the property which belongs to [them] by right of ownership." (Article 8 (1)). Collected Legislation of Russia Booklet III.1-2 (W.E. Butler ed. & trans 1992).

The Fundamentals of Civil Legislation reflects a number of significant advances in civil law, but few that contradict or otherwise significantly affect the laws of secured transactions and loan agreements found in the Civil Code. In fact, the Civil Code provides greater detail on a number of relevant issues. Accordingly, throughout this paper the applicable provisions of the Civil Code are cited together with the provisions of the Fundamentals of Civil Legislation.⁹

Both the Fundamentals of Civil Legislation and the Civil Code are subject to amendment and modification in the normal course of enacting new commercial law, and many of their provisions touching on secured financing have been refined or modified by the new Law on Pledge.¹⁰ It may be expected that both laws will continue to undergo significant modification as new commercial law is enacted by the Federation. To the extent they are not repealed or restated in their entirety, however, they remain relevant not only as the historical precedent of the more recent commercial laws, but also as a source of law on issues not clearly addressed in the new laws.

The Law on Pledge is a recently enacted statement of the general legal principles of security agreements. In addition to provisions dealing specifically with real estate mortgages, it addresses other types of security agreements such as equipment or inventory mortgages and pawn

⁹ A restatement of the Civil Code is in preparation as of this writing, and could be completed by Summer, 1993.

¹⁰ In practice, provisions of the Fundamentals of Civil Legislation and the Civil Code have not been explicitly modified or repealed as new laws have been enacted, resulting in the existence of some significant contradictions in the law. This is a matter of consternation and confusion among Russian lawyers. As a matter of theory, it may be reasonable to assume that the provisions of the most recently enacted law will govern, but many Russian lawyers are reluctant to support that proposition without qualification.

transactions. While the Law on Pledge, together with the Code of Civil Procedure, is a relatively comprehensive statement of the legal principles governing real property mortgages, it will likely be supplemented by further codes and regulations.¹¹ Such additional codes may be enacted at the federal level, but may perhaps be enacted as well at the level of the Republics and other autonomous jurisdictions.¹²

11 As of February, 1993, there was at least one legislative committee of the Supreme Soviet drafting a legal code of real estate mortgages. The draft of that law provided to the author by the committee adds significantly to the existing Law on Pledge and is cited in this paper where relevant. See Draft of the Russian Federation Law on Mortgages, Supreme Soviet Committee on Budget, Planning, Taxes and Prices, January, 1993 (hereinafter the "Draft Law on Mortgage").

12 The allocation of legislative authority among the federal government and local governments of general jurisdiction, primarily the Republics, is in itself the subject for lengthy commentary. Supporting the notion of some local legislative rights in the area of mortgage law are the provisions of Article 81-1 of the Constitution of the RSFSR, which grants concurrent jurisdiction over legislation affecting land and housing to the Federal and Republican governments. See also RSFSR Constitution, Article 84-11 (rights of krais, oblasts and independent cities in the sphere of land and housing). In areas of concurrent jurisdiction the Federal government is to enact "fundamental principles" and the Republics are to enact "...their own legal regulations, including the passage of laws and other legal instruments, in conformity with these fundamentals." See Amendments and Additions to the Basic Law of the RSFSR, RSFSR Law No. 2708-I (1992).

At the same time, in a provision that may be compared to the "commerce clause" of the United States Constitution, Article 72 (g) of the RSFSR Constitution grants to the Federal Government exclusive jurisdiction over "the establishment of the legal bases of the unified market; financial, monetary, credit and customs regulations... ." Thus, in the opinion of some Russian lawyers, the roles of various levels of government in defining mortgage law may depend upon whether such law is considered a matter affecting housing and land or a commercial law necessary for establishment of unified financial markets.

If prior legislative enactments are given any weight in the interpretation, it is noteworthy that Article 8 of both the Fundamentals of Civil Legislation and the Civil Code

The Code of Civil Procedure is a crucial element of the existing system. It sets out detailed procedures for attachment and sale of pledged property, which procedures are incorporated by reference into the Civil Code and the Law on Pledge. It should be noted, however, that while the Code of Civil Procedure includes procedures for enforcing claims against residential property, there has been very little actual experience with such procedures, and few Russian lawyers know how the provisions of the law would be implemented in actual practice. Nevertheless, for the moment, the Code of Civil procedure is the only law that addresses the procedural issues of secured claims.

C. THE CIVIL CODES

C.1. Contracts, Generally

The Fundamentals of Civil Legislation and the Civil Code are in large part laws of contracts, and establish the right of individuals and corporations to enter into private commercial transactions to the extent permitted by law and their organizational documents.¹³

Permitted transactions include actions designed to establish, modify or terminate contractual rights or duties between individuals or organizations.¹⁴ All transactions

provide that relationships arising from rights to property shall be governed by the law of the place in which the property is located.

With respect to the regulation of real property mortgages, the Law on Pledge stipulates that "...the format for an agreement on the mortgage of buildings, structures...land lots and other facilities within the Russian Federation...is established by the legislation of the Russian Federation regardless of the locale of the execution of the agreement." Law on Pledge, Art. 10 (5). The scope of the term "format" is undefined.

¹³ Fundamentals of Civil Legislation, Chs. 3 and 8; Civil Code, Arts. 11, 12, 25, 41.

¹⁴ Fundamentals of Civil Legislation, Art. 26; Civil Code, Art. 41.

must follow the form specified by the law,¹⁵ which may include the necessity of a writing and notarization.¹⁶ If provided in the law, failure to adhere to statutory form will invalidate a transaction.¹⁷

Transactions may be declared invalid by the courts as illegal or against "the interests of the State and Society,"¹⁸ as ultra vires,¹⁹ because of a party's lack of legal capacity,²⁰ or because of false pretenses, deceit, duress, or unconscionability.²¹

Invalid transactions may be unwound by the return of all property exchanged or, if that is not possible, by the payment of the cash equivalents.²² Invalidation of a contractual provision will not invalidate the entire

¹⁵ Fundamentals of Civil Legislation, Art. 30; Civil Code, Art. 42.

¹⁶ Fundamentals of Civil Legislation, Art. 27; Civil Code, Arts. 44, 47.

¹⁷ Fundamentals of Civil Legislation, Art. 30 (2); Civil Code, Art. 45, 48.

¹⁸ Fundamentals of Civil Legislation, Art. 30; Civil Code, Arts. 48, 49. The provisions of Article 49 of the Civil Code, which impose confiscatory penalties on contracts that are "against the interests of the State or Society," have not been included in the Fundamentals of Civil Legislation, and the continuing validity of those provisions is in doubt. This is not to say, however, that the concept of invalidating some types of contracts that violate established principles of public policy will not survive, perhaps in the restatement of the Civil Code now under consideration.

¹⁹ Civil Code, Art. 50.

²⁰ Civil Code, Arts. 51, 52, 54, 55, 56.

²¹ Civil Code, Arts. 57, 58.

²² Fundamentals of Civil Legislation, Art. 30 (3); Civil Code, Art. 48.

contract if the transaction could have been concluded without the invalid provision.²³

C.2. Pledge of Property

Individuals are granted the right to own a home as personal property and to possess, use and dispose of it in accordance with the limits of the law.²⁴ Citizens are granted the right to pledge an interest in a home, and homes are generally made subject to execution sale by judgement creditors.²⁵

Secured creditors are granted priority over other creditors with respect to the pledged property, subject to

²³ Civil Code, Art. 60.

²⁴ Fundamentals of Civil Legislation, Arts. 45, 51; Civil Code, Arts. 92, 105.

²⁵ Fundamentals of Civil Legislation, Arts. 45, 68; Civil Code, Arts. 114, 194; Code of Civil Procedure, Art. 369. By reference to the Code of Civil Procedure, the Civil Code specifically exempts from execution sale the principal residence of a farm family unless the debt being enforced was used for construction of the residence. See Code of Civil Procedure, Schedule 1. Also exempted from execution sale are shares in cooperative organizations if the judgement debtor has not been expelled from the cooperative organization. Id. To the extent that this latter exemption remains effective, and there are some doubts as to its continuing validity, it may have an effect on the ability of members of cooperative housing associations to mortgage their cooperative ownership rights, as discussed further at Section II.B.5, *infra*.

The Civil Code also prohibits secured transactions affecting state property, defined to include land, buildings, structures, plant and other fixed assets of state owned enterprises, as well as the real property assets of collective farms, trade unions and other social organizations. See Civil Code, Chs. 8, 9 & 10. The continuing validity of these provisions of the law in light of the rapidly changing nature of Russian property rights appears to be questionable at this time; they are implicitly contradicted by the more recent commercial laws. It is perhaps also worth noting that none of these restrictions on secured transactions were retained in the Fundamentals of Civil Legislation.

certain statutory priorities set out in the Code of Civil Procedure.²⁶ The pledge contract must be in writing and must include all pertinent information, including an appraisal of the property and a description of the underlying debt obligation.²⁷ A pledge of a house must be notarized and registered with the executive committee of the local Soviet, and does not take effect until registered.²⁸

Secured creditors are given the right to unsecured deficiency judgements against debtors and to a secured claim against hazard insurance proceeds in the event of damage to the property.²⁹ In addition to the principal balance of the loan, the pledge agreement may also secure accrued interest (including interest penalties), losses caused by delay or property damage, and the costs of foreclosure.³⁰

C.3. Debt Instruments

The civil codes recognize loan agreements and contracts to pay money,³¹ and permits interest to be charged on such

²⁶ Fundamentals of Civil Legislation, Art. 68 (4); Civil Code, Arts. 186, 192, 194; Code of Civil Procedure, Arts. 419-424. The statutory priorities of the Code of Civil Procedure are discussed infra at Section I.E.2.

²⁷ Civil Code, Art. 195.

²⁸ Civil Code, Arts. 195, 197, 239. It seems unlikely that the requirement to register mortgages with the local Soviet will continue to apply if appropriate registries for all land and property interests are designated under other laws. The Law of Pledge states only that mortgages are to be registered with the agency authorized by law to accept registration. The Draft Law on Mortgage (supra at note 11) requires registration in the land cadastre maintained by the local Committee on Land and Land Resources, which is a local government agency, and provides detailed instructions for the registration process.

²⁹ Civil Code, Art. 200.

³⁰ Civil Code, Arts. 192, 219.

³¹ Fundamentals of Civil Legislation, Arts. 113, 57; Civil Code, Arts. 158, 269.

obligations.³² Other important provisions relating to financial obligations addressed in the law include the right of a creditor to reject partial payments,³³ the enforcement of joint and several obligations,³⁴ the recognition of late payment penalties³⁵ and the rights and obligations of guarantors of financial obligations.³⁶

Assignment ("concession") of debt and security instruments is permitted if not prohibited by law or the terms of the agreement.³⁷ If a financial obligation is

³² Fundamentals of Civil Legislation, Art. 113; Civil Code, Art. 176.

³³ Civil Code, Art. 170.

³⁴ Fundamentals of Civil Legislation, Art. 67 (2); Civil Code, Arts. 180-183.

³⁵ Fundamentals of Civil Legislation, Art. 66 (3); Civil Code, Art. 226.

³⁶ Fundamentals of Civil Legislation, Art. 68 (6); Civil Code, Arts. 203-208.

³⁷ Fundamentals of Civil Legislation, Art. 69 (1); Civil Code, Art. 211. These limited provisions of the civil codes dealing with financial obligations appear to be the only Russian laws addressing what would be considered promissory notes or other forms of transferable commercial paper in other legal systems. The Fundamentals of Civil Legislation provides a taxonomy of permitted financial instruments, including "bills" or promissory notes, but goes no further. (See Fundamentals of Civil Legislation, Ch. 4.) However, while the provisions on transfer of financial obligations, for example, are quite simple in comparison to the elaborate body of American law codified in Article 3 of the Uniform Commercial Code, this is not to say that they are inadequate for the purposes of residential mortgage lending. See discussion under Section II.E., *infra*.

The author has been advised by lawmakers that legislative committees of the Supreme Soviet are considering western models of laws of negotiable instruments, and in fact there has been enacted in 1992 a Statute of Cheques (Supreme Soviet Decree No. 2349-I), dealing with bank drafts and checks, that incorporates many of the basic concepts of Article 4 of the American Uniform Commercial Code.

transferred by the creditor, the rights under the security agreement must also be transferred.³⁸

A debtor has the right to raise against the assignee of the debt those "objections" he was pressing against the assignor at the time he received notification of the assignment.³⁹ Assigning creditors are held liable to assignees for any defect in the enforceability of the debt obligation, though not for the debtor's failure to perform.⁴⁰

D. LAW ON PLEDGE

D.1. Organization

The Law on Pledge is divided into five sections. Section One sets out general principles affecting all mortgage transactions. Section Two deals with mortgages where the mortgaged property remains in the possession of the mortgagor,⁴¹ and is itself divided into three chapters

³⁸ Civil Code, Art. 211.

³⁹ Civil Code, Art. 214. It appears that Article 214 establishes a simple concept of "holder in due course" with respect to transferable financial instruments. The law allows debtors to press against the transferee ("new creditor") objections "...which he had been pressing against the original creditor at the moment he received notification of the concession of the claims." By implication, objections raised after the assignment of the debt which arise from events occurring prior to the transfer are disallowed.

⁴⁰ Fundamentals of Civil Legislation, Art. 69 (1); Civil Code, Art. 212. It is not provided that debt instruments may be transferred by agreement of the parties without recourse to the transferor, but neither is it prohibited.

⁴¹ The Law on Pledge uses the term "Hypotheca" or "hypothecary agreement" to refer to mortgages in which the property remains in the possession of the mortgagor. From the Latin, this term has also been used in the American and English common law systems to denote such mortgages, but the term is largely archaic in those systems, having been replaced by the general term of "mortgage." The term is in use in other civil law systems, however. See Black's Law Dictionary 668 (5th ed. 1979).

setting out general principles affecting all such mortgages, principles affecting mortgages of land and buildings, and principles affecting goods in circulation and production.

Section Three of the law deals with mortgages under which possession of the asset is delivered to the mortgagee, and is addressed primarily to pawn transactions. Section Four deals with mortgages of incorporeal rights, including leasehold rights, and Section Five sets out guarantees against state interference with mortgage contracts generally.

Legal aspects of mortgages not addressed specifically in the Law on Pledge are subject to the provisions of other existing laws,⁴² which would include the provisions of the Civil Code and the Code of Civil Procedure.

D.2. Property Subject to Mortgage

Property subject to mortgage includes any property which an eligible mortgagor has the legal right to alienate.⁴³ Such property includes buildings, structures, and apartments, or leasehold interests in buildings, structures, and apartments.⁴⁴ Mortgaging a leasehold

⁴² Law on Pledge, Art. 2.

⁴³ Law on Pledge, Art. 6. That privately owned housing may be alienated by the owner in private market transactions, without restriction, has been settled. See On Changes and Amendments to the Basic Law (Constitution) of the Russian Federation, supra at note 4, at Art. 12; RSFSR Law on Ownership, supra at note 8, at Art. 13 (1),; Law of the RSFSR On Privatization of the Housing Stock, July 4, 1991, at Art. 3.

⁴⁴ Law on Pledge, Arts. 4 (2), 19, 35, 54. The law also allows mortgage of property held under "full economic management," a form of Russian property right generally used to define the rights of enterprises or associations to the state owned assets which they possess and manage. The property right of full economic management is not relevant to single family home ownership, but may apply to multifamily housing owned by state enterprises or other associations.

interest may be prohibited by the property owner under the terms of the lease.⁴⁵

While structures and buildings may be mortgaged, and such a mortgage will constitute a mortgage also on the underlying land or right to its use,⁴⁶ undeveloped land is not subject to mortgage under the Law on Pledge.⁴⁷ Rather, under Article 41, land mortgages are subject to the "land and other legislation" of the Federation.⁴⁸

45 Law on Pledge, Art. 19.

46 Law on Pledge, Art. 42.

47 At the time the Law on Pledge was enacted, undeveloped land was inalienable. See the discussion at note 48, *infra*. By defining mortgageable property in terms of its alienability, as the laws of land ownership and alienability change, which they are doing rapidly, there may be no need for an amendment to the Law on Pledge to permit a mortgage of undeveloped land.

The Draft Law on Mortgage (supra at note 11) explicitly recognizes the right to mortgage plots of land, either with or without appurtenant structures.

48 Law on Pledge, Art. 41. The basic land law of the Federation at this time is the Land Code of the RSFSR, April 25, 1991. Collected Legislation of Russia, (W.E. Butler ed. & trans. 1992). This law enacted the right to own land for housing construction in an inheritable life estate (Article 7), but it stopped short of granting free rights of alienation. The Land Code states only that sale or other alienation of land is subject to the provisions of Article 12 of the RSFSR Constitution, the prior version of which was more restrictive than the recent amendment. See supra note 4.

As of this writing the land law of the RSFSR is developing rapidly, marked by the recent amendment to Article 12 of the Constitution. The new amendment to Article 12 provides that plots of land can be alienated and sold by their owners in private market transactions if the land is used for housing purposes. The upshot of this amendment would seem to be nullification of all prior legislation placing restrictions on the right to own and alienate, including mortgage, land appurtenant to housing. However, as noted earlier, there is already some question about the scope of the recent amendments to Article 12. See supra note 4.

The Land Code allows the mortgage of land only to a "land bank," which the law fails to define. Recent

A mortgage may cover property acquired after the date of the mortgage, provided such property is adequately described in the agreement,⁴⁹ and may be taken as security for future advances of funds.⁵⁰

D.3. Form of Mortgages

Mortgages may be established by contract or law.⁵¹ If by contract, it must be in writing⁵² and notarized.⁵³

conversations with Russian lawmakers suggest that the land bank envisioned by the Land Code would be a quasi-governmental financial institution established by local governments to facilitate the transfer of land between private parties and generally make a market in land pending further development of property rights in non-residential land. While the land bank concept may be no longer relevant to residential land, it perhaps remains relevant to other types of land which, even under the amended Article 12, may be subject to 5 an 10 year moratoriums on private market sales transactions.

As of this writing a revision of the RSFSR Land Code was in preparation in the Supreme Soviet and may be enacted as early as March, 1993.

⁴⁹ Law on Pledge, Art. 6 (3).

⁵⁰ Law on Pledge, Art. 4 (3). The provision for future advances is essential for construction lending. However, the legal issue of claims against the property arising between the time the mortgage is registered and funds are advanced, or between advances of funds during construction, is not specifically addressed in the law. Consequently, the treatment of claims such as building contractors' liens, so central to American construction loan mortgages, is ambiguous under this law.

Because the law permits future advances, and gives an unqualified priority to mortgages registered first in time, it is perhaps intended that all liens arising subsequent to registration of the mortgage will be subordinate to the full amount stated in the registered mortgage. It seems more likely, however, that this issue was not considered.

⁵¹ Law on Pledge, Art. 3 (1). The concept of a "mortgage by law" appears to be equivalent to a statutory lien under American law and would include, for example, mechanics or contractors' liens or the tax liens of governments. In fact, drafts of mortgage laws under consideration by working groups of the Supreme Soviet and provided to the author have included statutory liens in favor of the claims of construction contractors.

The format of real property mortgages (buildings, structures and land lots) is to be established by federal law.⁵⁴ The law also seems to say that the rights and obligations under the mortgage document will be determined under the law of the country in which the mortgagor is incorporated or has his primary residence.⁵⁵

Failure to adhere to the specified format is cause for nullification of the mortgage agreement.⁵⁶

Real estate mortgages must be registered in the land records of the area in which the property is located,⁵⁷ and

⁵² Law on Pledge, Art. 10 (2).

⁵³ Law on Pledge, Art. 43. The requirement for notarization assumes that the single family residential mortgage, either of an apartment or a freestanding home, is a "hypotheca" agreement as defined under the Law on Pledge. Hypotheca are defined to apply to any structures, buildings or other assets "directly appurtenant to the land." (Article 43.) In light of the requirement found in Article 239 of the Civil Code for notarization of pledges of residential property, it is perhaps safe to assume that the Law on Pledge intends for all real estate mortgages to be in notarial form. The Draft Law on Mortgage (supra at note 11) makes clear that all real estate mortgages are to be notarized.

⁵⁴ Law on Pledge, Art. 10 (5). See also supra note 12.

⁵⁵ Law on Pledge, Art. 10 (6) In the absence of further interpretation of this provision, its meaning is open to question. If it means, for example, that a resident of New York State mortgaging property it owns in Russia would have the benefit of the mortgage law of New York, it is a substantial departure from property law of other countries, in which rights and obligations regarding land are determined in accordance with the law of the locality in which the land is located. It also appears to be inconsistent with Russian civil laws which provide that local law governs rights pertaining to real property. See Fundamentals of Civil Legislation, Art. 8; Civil Code, Art. 8.

⁵⁶ Law on Pledge, Art. 12.

⁵⁷ Law on Pledge, Art. 43.

are considered ineffective until properly registered.⁵⁸ The responsible state registry may impose a tax on mortgage registration, and upon payment of the tax and presentation of the mortgage in proper format is obligated to accept the document and provide the parties with appropriate certificates of registration.⁵⁹ The registry must also provide registration information to other "interested persons,"⁶⁰ and bears liability for damages caused by its own violation of the law and regulation governing registration.⁶¹

⁵⁸ Law on Pledge, Art. 11. Property registration systems tend to fall into one of two broad categories depending upon whether registration of the property interest is optional or mandatory. (Other classifications of systems -- for example, between the document recordation systems widely used in the United States and the Torrens title registration systems used elsewhere -- may of course be made). The system used in the United States, for example, is optional, and registration of interests in land generally is not required by law. Unregistered interests in land are legally effective between the parties to a land transaction, but may be ineffective as to an innocent third party who relied on the record. Of course, those who fail to register their interest under an optional system do not obtain the legal protection provided by the registration system and could suffer severe consequences.

The second type of land registration system, which is used in much of Europe, requires that interests in land be registered, and unregistered land transactions are simply ineffective. As reflected in the Law on Pledge, Russia seems to be moving toward a mandatory registration system, in which registration is necessary to the effectiveness of the transaction, even between the parties. However, as of yet there is no comprehensive Russian law addressing the various issues involved in a property registration system.

⁵⁹ Law on Pledge, Art. 15.

⁶⁰ Law on Pledge, Art. 14.

⁶¹ Law on Pledge, Art. 16.

D.4. Rights and Obligations of Parties

The Law on Pledge is structured to allow the parties to establish their rights and obligations by agreement, the terms of the law applying in the absence of agreement.

Corporate mortgagors and mortgagors registered as "entrepreneurs" are obligated to accurately register the mortgage within 10 days of its effective date, keep accurate records of the mortgage, and provide record information to "interested persons."⁶² Such mortgagors bear the responsibility for accurate and timely registration and are liable to other parties for errors.⁶³ These provisions of the law apparently are not meant to apply to individual debtors who take mortgage loans for non-business reasons; the obligations and liabilities of such debtors in the registration process are therefore undefined in the law.

All mortgagors are obligated to inform potential mortgagees of the existence of all prior mortgages affecting the property, and are liable for any damages caused by their failure to do so.⁶⁴

Upon partial or complete satisfaction of the debt, the mortgagor may demand from the mortgagee a certificate of satisfaction for registration in the mortgage records.⁶⁵ However, the mortgage remains in effect to the extent of its entire initial amount until the debt has been satisfied in full, unless otherwise agreed by the parties.⁶⁶

Unless otherwise provided in the law or agreement, the mortgagor retains the right to possess, use and manage the property, dispose of the property by lease or otherwise, and

⁶² Law on Pledge, Art. 18.

⁶³ Law on Pledge, Art. 18 (2).

⁶⁴ Law on Pledge, Art. 22 (2).

⁶⁵ Law on Pledge, Art. 17 (1).

⁶⁶ Law on Pledge, Art. 25.

place second liens on the property,⁶⁷ but is obligated to notify the mortgagee of any lease of the property.⁶⁸

The parties may agree on allocation of responsibility to insure and maintain the property, but in the absence of agreement the mortgagor bears responsibility.⁶⁹

Unless otherwise provided in the agreement, the mortgagee has the right to inspect the property⁷⁰ and to require cessation or termination of any encroachments or other matters threatening damage to the property.⁷¹ A mortgage agreement may prohibit second mortgages, but in such event the mortgage debt becomes payable at any time, presumably without premium or penalty.⁷²

In the event that a mortgagor fails to maintain and insure the property in accordance with the terms of the mortgage contract, the mortgagee has the right to accelerate the debt and seek foreclosure.⁷³

The mortgagee has a preferential right to insurance proceeds in the event of damage to the property,⁷⁴ and may require that insurance proceeds be used to repay the debt.⁷⁵ While it is not stated that the parties may agree on the use of insurance proceeds -- for example, that they will be reserved for restoration of the property -- the general structure of the law supports this conclusion.

67 Law on Pledge, Art. 37.

68 Law on Pledge, Art. 38.

69 Id.

70 Law on Pledge, Art. 36.

71 Id.

72 Law on Pledge, Art. 45.

73 Law on Pledge, Art. 39.

74 Law on Pledge, Art. 9 (3).

75 Law on Pledge, Art. 38.

Section Five of the law generally obligates the government to reimburse the mortgagee for any losses incurred by government taking of mortgaged property or abrogation of any legal rights of the mortgagee under present law.

D.5. Enforcement and Priorities

Claims for enforcement of mortgages are to be carried out through judicial process or in arbitration tribunals.⁷⁶ However, if permitted by legislation, claims may be processed by notarial action without judicial procedure.⁷⁷ The law also provides that foreclosure sales will be carried out in accordance with the provisions of the Code of Civil Procedure "...unless otherwise provided in the [Law on Pledge] or by agreement."⁷⁸ The implication of this provision seems to be that the parties to a mortgage can agree to alternatives to judicial sale of property set out in the Code of Civil Procedure.

There is no doubt that prior mortgagees have priority over subsequent or junior mortgagees.⁷⁹ However, as

⁷⁶ Law on Pledge, Art. 28 (1). The Code of Civil Procedure provides that disputes that by law may be submitted to arbitration may be submitted by mutual agreement of the parties. See Code of Civil Procedure, Art. 28. However, the state arbitration tribunals are essentially commercial courts intended to hear disputes between commercial and corporate entities of all types, including individual entrepreneurs; it is unlikely that they would hear a typical foreclosure suit against a natural person unless the forum was chosen by the creditor. The arbitration tribunals have their own rules of procedure, but these rules apparently do not address the crucial procedural questions of foreclosure auction sales. Accordingly, to enforce its judgements an arbitral tribunal would also have to rely on the procedures set out in the Code of Civil Procedure. See The Code of Arbitral Procedure of the Russian Federation, FBIS-USR-92-069, 8 June 1992.

⁷⁷ Law on Pledge, Art. 28.

⁷⁸ Law on Pledge, Art. 28 (2).

discussed further below, the general reference to the Code of Civil Procedure raises questions about certain preferences for non-secured creditors set out in that law that are prior to the rights of mortgagees.⁸⁰

Mortgagees are entitled to deficiency judgements,⁸¹ and the lien of the mortgage automatically applies to the outstanding principal balance, compensation for losses caused by delay, and the costs of foreclosure and property maintenance incurred during pendency of a foreclosure.⁸²

Mortgagors are entitled to surplus proceeds from sale of the property,⁸³ and may redeem the property at any time up to the actual sale of the property.⁸⁴ The right of redemption may not be waived by agreement of the parties to the contract.⁸⁵

Article 24 of the Law on Pledge permits a mortgagee to commence foreclosure proceedings "...if, as of its due date, an obligation secured by a mortgage will not be fulfilled." Article 39 allows a mortgagee to commence foreclosure proceedings prior to maturity of the debt in the event that the mortgagor breaches his obligation to insure or preserve the property. However, Article 31 (2) specifically states with respect to installment debts that the mortgagor has the right to suspend a foreclosure proceeding by paying only the overdue portion of the debt.⁸⁶ This right may not be waived

79 Law on Pledge, Art. 22 (1).

80 Code of Civil Procedure, Arts. 418-424. See the discussion at Section I.E.2, *infra*.

81 Law on Pledge, Art. 29.

82 Law on Pledge, Art. 23.

83 Law on Pledge, Art. 30.

84 Law on Pledge, Art. 31 (1).

85 Law on Pledge, Art. 31 (3).

86 Law on Pledge, Art. 31 (2).

by agreement of the parties.⁸⁷ The law does not restrict the time in which the debtor may make the overdue installment payment, require that any such payment include reimbursement of the creditor's costs, or place any restriction on the number of times a debtor can take advantage of this provision of the law over the term of a mortgage.⁸⁸

E. CODE OF CIVIL PROCEDURE

E.1. General Procedure

The Law on Pledge provides only that a foreclosure proceeding is to be processed in a court or in an arbitration tribunal.⁸⁹ The actual process of foreclosing on a pledged residential property is set out in the Code of Civil Procedure. The Law on Pledge modifies none of the existing procedural rules governing the attachment and sale of pledged real estate, but rather incorporates by reference the relevant provisions of the Code of Civil Procedure.⁹⁰

An action for collection of a debt is commenced by filing a claim in the district court.⁹¹ The court itself

⁸⁷ Law on Pledge, Art. 31 (3).

⁸⁸ While the Law on Pledge does not specifically require that payments made to cure defaults include reimbursement of the creditor's costs and damages, Article 70 (1) of the Fundamentals of Civil Legislation holds debtors liable for damages caused by "improper performance" of obligations. As a civil law, the Law of Pledge should be read in the context of the Fundamentals of Civil Legislation, and it is probably safe to assume that a creditor could refuse to accept tender of an installment payment that did not include provable costs and damages from the debtor's default.

⁸⁹ Law on Pledge, Art. 28. See also supra note 76.

⁹⁰ However, as noted supra at note 78, the Law on Pledge appears to permit modifications to the foreclosure sale provisions of the Code of Civil Procedure by agreement of the parties.

⁹¹ Code of Civil Procedure, Art. 126.

serves process on the named defendant and, after preliminary hearing, determines whether additional defendants or co-plaintiffs should be brought into the action.⁹²

The court ruling is in the form of a judgement on the debt.⁹³ In cases where the debt is secured by pledge, the court may include in the judgement a valuation of the property.⁹⁴

The judgement on the debt takes affect only after the 10 day appeal period has run.⁹⁵ However, upon petition by the creditor, the court may order immediate execution on the property if delay in execution might lead to prejudice to the creditor.⁹⁶

Upon receipt of judgement, and pending expiration of the appeal period, the creditor is issued a warrant of execution.⁹⁷ Once effective, the warrant is delivered to the bailiff of the court for execution,⁹⁸ whereupon the bailiff serves notice on the defendant requesting voluntary compliance with the judgement within 5 days. Upon receiving no satisfaction within the 5 day grace period, the bailiff executes upon the property by attachment and sale.⁹⁹

If the security property is a residential building, prior to sale the bailiff is obligated to investigate the

92 Code of Civil Procedure, Art. 141.

93 Code of Civil Procedure, Art. 191.

94 Code of Civil Procedure, Art. 200.

95 Code of Civil Procedure, Art. 208.

96 Code of Civil Procedure, Art. 211.

97 Code of Civil Procedure, Art. 340.

98 Code of Civil Procedure, Art. 348.

99 Code of Civil Procedure, Art. 356.

state of title and notify any secured creditors.¹⁰⁰ The property is delivered for sale at public auction not earlier than 5 nor more than 30 days after imposition of the bailiff's attachment.¹⁰¹ Until the 30th day the mortgagor may redeem the property by payment of the debt.¹⁰²

Bailiffs must give notice to mortgagors and secured creditors not less than 10 days prior to the public auction.¹⁰³ The bailiff sets a value on the property if one has not been set by the court,¹⁰⁴ but if either the creditor or debtor objects to the valuation, the bailiff is obligated to obtain an expert appraisal.¹⁰⁵

At the initial auction sale the bidding must start at the appraised value,¹⁰⁶ and bidders must deposit 10% of the value with the bailiff.¹⁰⁷ The auction may be declared

¹⁰⁰ Code of Civil Procedure, Art. 377. The bailiff is also required to verify the true value of the building and register the "attachment" of the property with the local Soviet and notarial office. Whether these procedures will continue to be followed in the face of housing privatization and further development of the law of mortgages is questionable.

In American mortgage foreclosure actions an "attachment" is irrelevant because the property is already subject to the recorded mortgage lien and the foreclosing party needs only the court judgement to proceed; an order of attachment is not necessary. It is probably so under the Russian Code of Civil Procedure as well, but that law sets out the same procedure for secured creditors and judgement creditors alike, and makes no distinctions in the use of the term "attachment" for the bailiff's act of obtaining possession of the property prior to auction sale.

¹⁰¹ Code of Civil Procedure, Art. 398.

¹⁰² Id.

¹⁰³ Code of Civil Procedure, Art. 400.

¹⁰⁴ Code of Civil Procedure, Art. 373.

¹⁰⁵ Id.

¹⁰⁶ Id.

¹⁰⁷ Code of Civil Procedure, Art. 402.

invalid by the bailiff if there are less than two bidders, if there is no bid higher than the official valuation, or if the high bidder fails to perform.¹⁰⁸

If the auction is declared invalid, the judgement creditor may apply to the court to take the property at the official valuation.¹⁰⁹ If the judgement creditor declines this right, a second auction is held at which the amount of the opening bid is unrestricted.¹¹⁰

E.2. Priorities

The costs of foreclosure have first priority in distribution of auction proceeds.¹¹¹ In levying execution on pledged property, the recovery of a "state credit institution" is subordinate to any unsecured claims against the debtor for family maintenance payments, outstanding tort judgements, and a variety of other obligations of the debtor that would generally result from an employment relationship.¹¹² The recovery of a secured creditor that is not a "state credit institution" is subordinate also to payment of the debtor's outstanding local taxes and compulsory state insurance premiums.¹¹³ A creditor that

¹⁰⁸ Code of Civil Procedure, Art. 403.

¹⁰⁹ Code of Civil Procedure, Art. 404.

¹¹⁰ Id.

¹¹¹ Code of Civil Procedure, Art. 416.

¹¹² Code of Civil Procedure, Arts. 419-424. The "first order" recoveries to which all secured creditors are subject also include:

"...demands of workers and employees deriving from labor law relations; demands for the payment of remuneration due to authors for the utilization of copyright or the rights to a discovery, an invention for which a certificate of authorship has been issued, and a rationalization proposal; ... [and] demands under social insurance... ."

takes possession of the property without auction is obligated to pay all superior claims, to the extent of the value of the property.¹¹⁴

The bailiff is required to prepare and submit for the court's approval an accounting of distributions, which accounting is subject to motions to set aside or modify the distribution.¹¹⁵

E.3. Appeals and Protests

Upon application of the debtor during the foreclosure proceeding, and upon taking into consideration the financial circumstances of the debtor, the court hearing the case may order deferral of execution, settlement of the outstanding debt in installments, or modification of the methods and procedures of execution on the property.¹¹⁶

All judgements are subject to appeal to a higher court within 10 days of entry, and are ineffective pending expiration of the appeal period.¹¹⁷ Upon expiration of the appeal period the judgement becomes final and further appeals by the parties disallowed.¹¹⁸ Decisions on the right of immediate execution may also be appealed, but such appeals do not stay the order for immediate execution.¹¹⁹

In addition to the rights of appeal given to the parties to the action, higher courts are given the right to review all judgements of lower courts, even those deemed

113 Code of Civil Procedure, Arts. 419-424.

114 Code of Civil Procedure, Art. 424.

115 Code of Civil Procedure, Art. 427.

116 Code of Civil Procedure, Art. 207.

117 Code of Civil Procedure, Art. 208.

118 Code of Civil Procedure, Art. 428.

119 Code of Civil Procedure, Art. 211.

final, upon the petition of certain officials, including the Office of the RSFSR Procurator General or members of the Presidiums of the high courts of the Federation or its autonomous Republics.¹²⁰

Appeals courts generally have from 10 to 60 days to decide an appeal, depending upon the level of court hearing the appeal.¹²¹ All facts and law of the case are subject to review on appeal.¹²²

The acts of the bailiff in the auction proceeding may be appealed to the court of first instance by any party having an interest in the property within 10 days of the date of the contested act or, if the person had no notice of the time and place of the act, within 10 days of the date on which such person became aware of the act.¹²³ The court's decision in such challenges may be appealed.¹²⁴ In addition, upon motion of an interested party, an auction sale may be declared invalid by a court at any time within 3 years of the date of the auction on the grounds that it was conducted in violation of the rules or involved malpractice by the bailiff, creditor or debtor, and the declaration of invalidity is itself subject to appeal.¹²⁵ If the appeal is

120 Code of Civil Procedure, Chapter 36.

121 Code of Civil Procedure, Art. 284-1.

122 Code of Civil Procedure, Arts. 294, 327.

123 Code of Civil Procedure, Arts. 428, 429.

124 Code of Civil Procedure, Art. 428.

125 Code of Civil Procedure, Art. 405. The relationship of Article 405 to Article 428, which requires that challenges to the auction sale be brought within 10 days of the date of the sale or the date on which the defect is discovered, appears to be that the three year limitation of Article 405 serves as a statute of limitations for all challenges to an auction proceeding.

In cases in which the actions of a foreclosure sale purchaser are criminally actionable, the 3 year period of

brought after the sale of the property, the purchaser must be made a party to the action.¹²⁶

In the event of an appeal or protest of a judgement or auction proceeding, whether to a higher court or the court of first instance, the court hearing the appeal must decide whether to quash the execution sale as well.¹²⁷ If the judgement underlying an execution sale is quashed, the execution sale must be reversed and the debtor's property returned to him.¹²⁸

Upon entry of a judgement against the debtor, a court is required to stay execution on the property in several circumstances, including "...contest by the judgement debtor of an execution document by judicial proceedings, where such contest is permitted by law."¹²⁹ The court has discretion to stay execution when a complaint is filed against the

appeal is extended to match the relevant criminal statute of limitations.

¹²⁶ Code of Civil Procedure, Art. 429.

¹²⁷ Code of Civil Procedure, Art. 431.

¹²⁸ Code of Civil Procedure, Art. 430. Article 430 appears to require that execution be set aside in the event an underlying judgement is overturned. However, Articles 431 and 432 appear to say that the court hearing an appeal or retrying a case sent back down on appeal must, on its own motion or application of a party, consider whether to set aside execution. Articles 431 and 432 thus suggest some judicial discretion as to whether to set aside an execution sale.

¹²⁹ Code of Civil Procedure, Art. 361. It is not clear that a "contest of an execution document" includes the usual right to appeal the judgement to a higher court. Other instances in which a court is required to stay execution include: (1) death of the debtor, if the legal relationship established by the judgement can pass to successors; (2) the debtor's loss of dispositive capacity; (3) the debtor's service in the armed forces; (4) the bringing of an action for the release of the property from attachment; (5) the filing of a petition of appeal against the acts of an administrative body; and (6) stay of the execution by an official, e.g. the Procurator General, authorized to do so by legislation.

actions of the bailiff in a foreclosure proceeding.¹³⁰ The duration of all stays of execution is generally limited to the time necessary to resolve the grounds of the stay.¹³¹

II. ANALYSIS AND RECOMMENDATIONS

A. GENERAL PRINCIPLES

The existing Russian law of real estate mortgages, as expressed in the Law on Pledge and the Code of Civil Procedure, can be marginally effective in its present stage of development. Much, of course, remains to be seen in how the laws are interpreted and enforced as the volume of residential mortgage lending increases.

¹³² But the laws themselves give creditors and debtors a relatively clear picture of their rights and obligations; provide a rational, though largely untested, system for enforcement of security rights in real estate; and attempt

¹³⁰ Code of Civil Procedure, Art. 362. Additional grounds for discretionary issuance of a stay of execution include (1) dissolution of a corporate debtor; (2) motion of a debtor who is called up for active duty in the armed services or other state duty, who is on a protracted state mission, or who is confined to a medical institution; and (3) where the debtor cannot be located.

¹³¹ Code of Civil Procedure, Arts. 361, 362.

¹³² For example, as discussed supra at Section I.E.1, the Code of Civil Procedure provides for auction sale of residential property by the bailiff of the district court. However, several Russian lawyers have pointed out to the author that there is probably not a court, let alone a bailiff, in the City of Moscow that has actually conducted a residential foreclosure proceeding in recent times.

to strike a balance between the rights of debtors and creditors.

Because high volume residential mortgage lending will be a new phenomenon in Russia, many of the issues that are resolved under other western legal systems may remain to be resolved in Russia. The United States, for example, has case law precedent on the finer points of mortgage law reaching back a century, and these precedents help to resolve issues not directly addressed in statutory law. Russia, as a code or civil law system, may need to deal with those finer points over time through the enactment of appropriate codes and regulations.

The conclusion of this paper is that the existing Russian law may be improved by some modification and clarification. The following analysis and recommendations frequently take the approach of the National Conference of Commissioners of Uniform State Laws of the United States as expressed in the Uniform Land Security Interest Act (hereinafter the "ULSIA"),¹³³ the guiding principal of which is that mortgage law should be structured to allow real estate financing to proceed with the greatest possible certainty and the lowest possible transaction costs.¹³⁴

¹³³ Uniform Land Security Interest Act (1985), 7A U.L.A. 1992 Supp. at 184 et seq. (herinafter the "ULSIA"). The ULSIA was prepared as a model law by the National Conference of Commissioners on Uniform State Laws and recommended for enactment throughout the United States as an attempt to bring uniformity to the diverse statutory and case law now governing secured real estate finance in the 50 American states. It is, to some extent, a simplification and codification of the law of the 50 states and the common law principles through which those laws are interpreted. A major impetus for the ULSIA was the recognition that, with the rapid development of secondary mortgage markets as the foundation of the American residential mortgage finance system, local financial markets have been superseded by a national markets. The law attempts to establish a system of uniform legal principles that a nationwide market requires.

¹³⁴ Id., at 187.

Economic theory argues, and actual experience has proved, that laws and procedures which increase the risk or transaction cost of lending will result in less lending or higher costs for borrowers, or both.

ULSIA assumes that the primary interest of the secured real estate creditor is to dispose of the collateral quickly and at minimal cost, to apply the proceeds of sale to reduction of the debt, and thereafter to proceed to collect a deficiency judgement from the other assets of the debtor.¹³⁵ The basic concerns of the debtor are to be protected against unfair lending practices and to protect his financial interest in the property to the extent it exceeds the amount of his debt.¹³⁶ On the basic issue of realization of the security, the creditor and the debtor have a common interest, which is to achieve the highest possible price for the property in foreclosure sale.¹³⁷

The ULSIA suggests that among the best ways to protect the interests of the debtor in foreclosure proceedings is to require adequate notice to debtors regarding the consequences of their actions and the options open to them to protect their own interests, and then provide them with adequate time to take curative action. The premise is essentially that the debtor's best protection is the ability to control his own situation through cure, refinancing or sale of the property.¹³⁸

135 Id., Comment 1 to Sec. 507.

136 Id.

137 Id.

138 Id. It should be noted that an additional emphasis of the ULSIA is the prohibition of deficiency judgements against debtors in residential foreclosures. Id., Comment 2 to Sec. 511. On this point it differs from the majority of American jurisdictions, only a handful of which have enacted "anti-deficiency" laws.

The ULSIA takes the position that much of the complexity in mortgage law and procedure is attributable to

An implied premise of the ULSIA is that legal requirements that impose costs on creditors -- for example, mandatory default notices and cure periods -- will not necessarily have significant impacts on the availability of funds or the cost of borrowing so long as such requirements are clear and uniform across the industry. Such requirements can be priced and become a normal cost of doing business. However, once such requirements are met, the process of enforcing mortgage security must be relatively swift and certain of outcome, as it is the unanticipated costs of delay and uncertain enforcement of the law that create the greatest risk.

In the following analysis, the Russian law is reviewed from the perspective of how it may potentially hinder or facilitate a high volume market in residential mortgage lending. An important component of such a market is in the first instance low transaction costs. Can residential mortgage loans be originated and enforced at a reasonable cost? The second major area of concern is the safety of mortgage investment, which depends primarily upon whether the security for mortgage loans can be realized expeditiously and with a high degree of certainty. Long delays in enforcing security arrangements can result in higher costs and risks to creditors, including costs associated with the loss of liquidity, losses mounting over time that can not be recouped because of a debtor's

the need to protect the financial interests of the debtor in imperfect market transactions such as foreclosure auction sales. The drafters of the ULSIA concluded that at least a portion of the risk to debtors could be alleviated by abolishing deficiency judgements, which would in turn simplify the process without placing creditors at undue risk. Id.

Whether the benefits of simplifying the foreclosure process balance the potential disincentive to creditors of foregoing deficiency judgements is a significant policy decision that may need to be based on more experience in the Russian context.

deteriorating financial condition, and the risk of property deterioration and loss of value.

This paper suggests further that a crucial element of a residential mortgage finance system is the systematic disclosure of pertinent mortgage information to prospective debtors so that they can be protected against unethical lending practices and make informed choices.

Finally, some attention is given to the issue of negotiable debt instruments and their role in the development of secondary mortgage markets and mobilization of investment for mortgage lending.

The following comments are divided into issues found in the Law on Pledge and those found in the Code of Civil Procedure. It should be noted that the following is not a comprehensive analysis of all of the differences between Russian mortgage law and American practice, but rather an outline of significant areas for investigation. A discussion of the many minor differences between the two systems could fill a large volume, and would be largely an academic exercise.

B. THE LAW ON PLEDGE

B.1. Acceleration of Debt

To "accelerate" an installment mortgage debt in the event of a debtor's default is to declare the entire amount of the debt immediately due, prior to maturity, and to deny the debtor the right to reinstate the contractual schedule of installment payments.

Acceleration is necessary to realize the security on installment debts under the theory that payments on an installment debt contractually are not due and payable until some future time, and therefore the creditor's rights of collection are limited to those installments actually due and unpaid.¹³⁹ To enforce a mortgage lien for those minor

amounts under current practice would be costly and inefficient and, under some circumstances, could result in prejudice to the creditor.¹⁴⁰

The Law on Pledge recognizes the right of a creditor to accelerate the debt in the event that the debtor fails to insure or preserve the property in accordance with the terms of the mortgage contract.¹⁴¹ It also allows a creditor to commence foreclosure proceedings if a payment is not made when due.¹⁴² Presumably, the right to foreclose after a default in payment of a loan installment presupposes the right to accelerate the entire debt, but that is not specifically stated in the law, only implied.

The problem lies with Article 31 of the Law on Pledge, which allows debtors to suspend any enforcement proceeding by paying only the overdue installment, and prohibits waiver of this right by contractual agreement of the parties.¹⁴³ Presumably, the right to suspend the proceeding exists at any time prior to completion of the foreclosure sale.

¹³⁹ To avoid this contractual interpretation, the right to accelerate an installment debt generally must be reserved in the mortgage contract.

¹⁴⁰ For example, possible results in some American jurisdictions when a debt is foreclosed for an overdue installment without acceleration would be extinguishment of the mortgage or a sale of the property subject to the creditor's continuing mortgage for the unpaid installments. See 55 Am. Jur. 2d Mortgages Sec. 556 (1971); Richard A. Powell & Patrick J. Rohan, 3 Powell on Real Property Sec. 463 (4) (1992) (hereinafter "Powell on Real Property"). These outcomes could effectively deny the creditor the security of the mortgage or the ability to review and approve the credit of the new debtor. As a practical matter, this issue does not arise often in American practice, as acceleration clauses in installment contracts are almost universally used.

It is not clear under the Russian law what the outcome would be in this situation.

¹⁴¹ Law on Pledge, Art. 39.

¹⁴² Law on Pledge, Art. 24.

¹⁴³ Law on Pledge, Art. 31 (3).

Article 31, as a practical matter, could defeat the purposes of acceleration and result in both high transaction costs and greater uncertainty in mortgage lending.

For example, assume a debtor who consistently fails to pay loan installments on time. The creditor, to get the debtor's attention and protect its own rights, is forced to seek enforcement of the mortgage. The act of bringing the claim is costly. In addition, depending upon market conditions, the creditor may be losing both interest and reinvestment earnings on the late payments. Each time this occurs, the debtor, at the last moment, pays the overdue installments, the claim is suspended, and, presumably, the loan is reinstated on its original terms. Presumably, under Article 70 (1) of the Fundamentals of Civil Legislation, upon curing the default the debtor would be required to compensate the creditor for its costs, though this requirement is not specifically stated in the Law on Pledge.¹⁴⁴

This is a costly and inefficient way to collect overdue payments. It might be argued that the present procedural law of Russia anticipates that the entire foreclosure process will be completed expeditiously, so the creditor's exposure is not great. However, the time for completion of foreclosure proceedings at present and under a fully developed, commercial legal system are unlikely to be the same. As processing time increases, so, generally, do the risks of secured lending.¹⁴⁵

¹⁴⁴ See discussion under note 88, supra.

¹⁴⁵ A question not addressed in this paper is the present capacity of the Russian judicial system to handle a substantial increase in civil actions arising from the many new laws enacted in recent years. As such actions increase, which must be viewed as a real possibility, unless the capacity of the judicial system increases commensurately it is likely that significant delays in process will be experienced. Consequently, a concern of the mortgage law at this time should perhaps be the effect of delayed legal

With respect to the provisions of Article 31, the law might specifically state that creditor's have the right to accelerate the entire debt prior to maturity for failure to make payments as due, subject to the statutory right to cure. If there is any question regarding the scope of Article 70 (1) of the Fundamentals of Civil Legislation, the law should specifically provide that debtor's who fail to make installment payments on time, leading to enforcement actions, are required to compensate the creditor for accrued interest on the unpaid installment and for the costs incurred in enforcing the claim, and that the creditor is permitted to reject tender of installments that do not include such amounts.

Finally, debtor's and creditors should have the right to agree contractually that the debtor can take advantage of the cure provision of Article 31 (2) only a limited number of times in the course of a year and over the term of the loan.

B.2. Priorities

Under the Law on Pledge, a creditor's right to proceeds realized from mortgage security is specifically subject only to the rights of a prior secured creditor.¹⁴⁶ However, the Law on Pledge further provides that sale of a mortgaged asset shall be carried out in accordance with the Code of Civil Procedure,¹⁴⁷ which, in addition to setting out procedural requirements for mortgage foreclosure, also establishes priorities for distribution of auction proceeds.¹⁴⁸ By implication, then, the distribution

process on enforcing security rights, and how the adverse effects of delay may be ameliorated. On this issue, see Section II.C.3, *infra*.

¹⁴⁶ Law on Pledge, Art. 22.

¹⁴⁷ Law on Pledge, Art. 28 (2).

¹⁴⁸ Code of Civil Procedure, Arts. 419-424.

priorities of the Code of Civil Procedure apply to mortgages made under the new Law on Pledge.

The Code of Civil Procedure establishes a system of priorities which distinguishes "state credit institutions" from other secured creditors. The right of state credit institutions to auction sale proceeds are subordinate to what are called "first order" recoveries, which apply primarily to employer/employee compensation obligations, but which also appear to include family maintenance obligations and outstanding tort judgements.¹⁴⁹ Secured creditors that are not "state credit institutions" are subordinate to preferences for the "first order" recoveries, but also to "second order" recoveries which include "demands of state or local taxes and non-revenue payments to the budget...and demands of organs of state insurance under compulsory insurance."¹⁵⁰

It appears from the law that first and second order recoveries against the proceeds of foreclosure sale need not be registered, may arise subsequent to the registration of the mortgage of the secured creditor, and need not be asserted by appearance in the foreclosure proceeding.¹⁵¹

As a general principle, the rights of mortgagees should be subordinate only to claims that are registered and available for inspection by the mortgagee at the time the mortgage is made. Otherwise, the creditor may be dependent

149 Id.

150 Code of Civil Procedure, Art. 420. It should be noted that the interests of "state credit institutions" are not by law superior to the interests of other secured creditors, but are simply subject to fewer superior claims. The entire distinction between state credit institutions and other creditors is of dubious significance at this point as there are few, if any, state banks that have not been converted to private sector institutions.

151 As a practical matter, no claims against real property are presently "registered" in accessible public records, as the necessary registries and procedures simply do not exist.

entirely upon representations of the debtor with regard to the existence of other potential claims.

The essence of a system of secured mortgage lending is that the rights of the secured creditor to the mortgaged property can be determined by a diligent inspection of the public records and the property. If other potential claims are not reflected in those records or in the physical use and occupancy of the property, the creditor is at risk.

The second crucial element of the mortgage system is that the rights of the creditor to the security are largely determined at the time the mortgage loan is made, and are unaffected by subsequent debts or obligations of the debtor. A statutory priority for any such subsequent obligations of the debtor would pose a significant risk for the creditor.

Other than property and income taxes owed to government, which under the American system also may remain a lien on the property after foreclosure,¹⁵² obligations of the debtor which are not reduced to judgement and/or properly registered prior to the time the mortgage is made should not have preference for distribution of foreclosure proceeds. Some attention should therefore be paid to the priorities for distribution set out in the Code of Civil Procedure to determine whether they may contradict this principle.

C.3. Alternatives to Judicial Foreclosure

The Law on Pledge presently requires that, if not otherwise provide by law, a claim against a mortgaged

¹⁵² In the American system, courts of some jurisdictions may order payment of the outstanding property taxes from the sales proceeds of foreclosure sale; in other jurisdictions the unpaid taxes are considered a continuing lien on the property after foreclosure sale. See 55 Am. Jur. 2d Mortgages Sec. 818 (1971). Income tax liens arising prior to the foreclosure sale are also continuing liens on the real estate, and may be unrecorded. With respect to tax liens, then, the present Russian law does not differ significantly from American practice.

property is to be processed by a court or in arbitration.¹⁵³ If not otherwise provided in the Law on Pledge or by agreement of the parties, the foreclosure sale is to be carried out in accordance with the auction sale rules of the Code of Civil Procedure, but the scope of parties' right to modify the statutory procedures is unclear.¹⁵⁴ The law also states that in circumstances stipulated in other laws, mortgage claims may be executed simply through notarial order, but no other laws appear applicable at this time.¹⁵⁵ It thus appears that the process for foreclosing a real estate mortgage will be the court supervised auction sale described in the Code of Civil Procedure unless the parties agree otherwise or unless further legislation is enacted authorizing alternative procedures.

While court supervised auction sale is effective, it may not be the most efficient and economical method of execution in many cases, most particularly undisputed cases or cases in which it is clear that there are no significant interests in the property adverse to the interest of the creditor. To promote economy and efficiency, additional

¹⁵³ Law on Pledge, Art. 28.

¹⁵⁴ Id.

¹⁵⁵ Id. Under existing Russian law there exists a procedure whereby for certain claims a creditor may lodge a complaint for collection of a debt and execution on pledged property with the state notarial office. Under that procedure the notarial office is obligated to advise the debtor of the nature and amount of the claim and request satisfaction. If no response is forthcoming from the debtor, the notary is authorized to issue a document of execution which may be delivered by the creditor to the bailiff of the district court for sale of the property. However, if a defense to the claim is raised, the procedure is put back into the courts.

The Law on Pledge apparently does not authorize use of this procedure for residential mortgage foreclosures. However, the Draft Law on Mortgage (supra at note 11) does include such a procedure as well as a procedure for the negotiated transfer of title from mortgagor to mortgagee.

legislation might be considered to authorize a simple conveyance of the property from the debtor to the creditor, or allowing the parties to agree to grant the creditor a private right of sale with minimal judicial supervision.

The crucial concern of such legislation would be to establish rules and procedures for both alternative methods of execution that achieve the goals of economy and efficiency while at the same time protecting the debtor against unfair practices.

The simple transfer of the property from debtor to creditor would be used primarily in those instances where the claim is not disputed and it is in the interests of both debtor and creditor to complete the transaction quickly and with minimum process. To protect the unsophisticated debtor, legislation authorizing such a procedure could require (1) that the debtor has been advised of his legal rights and the right to be represented by an attorney,¹⁵⁶ and (2) that the transfer to the creditor is made in complete satisfaction of the outstanding debt and that a deficiency judgement will not be sought by the creditor. It would also be possible to stipulate that the creditor would return to the debtor any proceeds from sale of the property

¹⁵⁶ An open question with respect to any process that relies on the ability of the debtor to take action to protect himself in complicated circumstances is whether the Russian legal system presently provides the average citizen with sufficient access to legal advice. In this respect, the Russian and American systems may differ significantly, as it is generally conceded that in the United States one cannot throw a stone in any direction without a high probability of hitting an attorney. For statutory rights of notice and cure to be truly effective, the process itself must be simple enough for the average citizen to participate either without assistance or under the protection of the court, or citizens should have access to legal assistance.

Russia does have a limited tradition of independent local offices of private defense attorneys or advocates, and the private practice of law does appear to be growing along with the market economy. Indications are at present, however, that the costs of private legal assistance may be beyond the means of the average citizen.

in excess of costs and amounts due under the debt obligation, or this could be left to agreement of the parties.

A second alternative to judicially supervised procedures is the right of unsupervised sale.¹⁵⁷ Unsupervised sale is permitted in about half of the American States and is the predominant form of execution in some European nations. Essentially, the right of unsupervised sale allows the creditor, under a contractual right reserved in the mortgage, to sell the property, by auction or negotiated sale, by complying with statutory rules.

The major concern of unsupervised sale is to insure that the statutory rules are followed and that the debtor has the right to challenge the proceeding in a court of law.¹⁵⁸ Typical rules may include: (1) that the debtor be

¹⁵⁷ The Draft Law on Mortgage (supra at note 11) provides for a variation of unsupervised sale by requiring that foreclosure sales be conducted by private auctioneers licensed by the state. The identity of the auctioneer is to be set out in the mortgage document, agreed to by the parties at the time of foreclosure, or selected by the court, and the results of the sale are to be subject to confirmation and approval by the court.

¹⁵⁸ But see the discussion at note 156, supra, regarding the availability of legal assistance. The ULSIA, supra at note 133, provides the following model article covering challenges to all sales of property or disposition of foreclosure proceeds:

Section 514. Creditor's Liability For Failure to Comply With [Law].

(a) A sale or disposition of proceeds may be ordered or restrained on terms and conditions determined by the court if it is established by the debtor or any other person entitled to notice under [this law] that:

- (1) the obligation is invalid;
- (2) the debtor is not in default;
- (3) the creditor or other person exercising a power of sale under [this law] is not complying or is not likely to comply with [this law]; or

provided with reasonable notice of the time, place and manner of sale, (2) that the sale be advertised and conducted in accordance with stipulated procedures, (3) that the debtor has the right to challenge the sale in a court of law for failure to follow stipulated procedures or other breach of good faith on the part of the creditor, and (4) that the proceeds of the sale will be applied by the creditor in the same manner as specified for a judicially supervised sale.¹⁵⁹

(4) the proceeds of any sale are not being applied or are not likely to be applied required by [this law].

(b) If disposition of the real estate has occurred, the debtor or any person entitled to notice under [this law] may recover from the creditor any loss caused by a failure to comply with [this law].

(c) If a creditor violates [this law], a [debtor] may recover, without reduction by reason of any unpaid portion of the debt or deficiency judgement owed the creditor and without proof of actual damages, an amount equal to one percent of the initial unpaid obligation but not exceeding \$500.

(d) In a judicial proceeding under this section, a [debtor], in addition to any other remedy granted, may recover the reasonable expenses of litigation, including reasonable attorneys fees.

¹⁵⁹ A model provision authorizing right of private sale is included in the ULSIA, supra at note 133, as follows:

Section 509. Creditor's Power of Sale After Default.

(a) If the secured creditor is authorized to foreclose by power of sale..., the secured creditor, after the debtor's default and upon compliance with this section, may sell any or all of the real estate that is subject to the security interest in its then condition or after any reasonable rehabilitation or preparation for sale. Sale may be at a public sale or by private negotiation, by one or more contracts, as a unit or in parcels, at any time and place, and on any terms including sale on credit, but every aspect of the sale, including the method, advertising, time, place and terms, must be reasonable. The creditor shall give the person entitled to notice under [this law]

Since the crucial protection for the debtor is that he receive adequate notice of the proceedings in time to bring a necessary challenge in court on the grounds that the creditor is not complying with, or will likely not comply with, the provisions of the law, it may be necessary also to require a reasonable period of time between completion of the sale, issuance of title to the auction purchaser and distribution of auction proceeds.

As an additional protection, a law could require that even unsupervised sales be confirmed by a court prior to issuance of title or distribution of auction proceeds, which automatically would give the debtor a forum for challenging the process. Even though this requirement may significantly detract from the policy objectives of the unsupervised sale procedure, it is nevertheless required in some American jurisdictions which allow unsupervised sales.¹⁶⁰ Yet other jurisdictions allow unsupervised sales, but require that the sale be conducted by a public official, such as a sheriff or bailiff.¹⁶¹

reasonable written notice of the time and place of any public sale or if a private sale is intended, reasonable notice of intention to enter into a contract to sell and of the time after which a private disposition may be made. The same notice must also be sent to any other person who has a recorded interest in the real estate which would be cut off by the sale, but only if the interest was on record at least seven weeks before the date specified in the notice as the date of any public sale or seven weeks before the date specified in the notice as the date after which a private sale may be made....The creditor may buy at any public sale and, if the sale is conducted by a fiduciary or other person not related to the creditor, at a private sale.

¹⁶⁰ See 55 Am. Jur. 2d Mortgages Sec. 679 (1971).

¹⁶¹ Id.

B.3. Registration

Several issues regarding the registration of mortgage documents arise under the provisions of the Law on Pledge.¹⁶²

The first concern, which is largely beyond the scope of this paper, are the legal principles for resolution of disputes regarding the priorities of registered documents. The general approach of the Law on Pledge is that documents registered first in time will be superior to interests registered subsequently. However, this simple formula may not address a number of equitable issues regarding the validity and priority of registered interests. For example, will a mortgage granted without financial consideration have priority over a subsequent mortgage given in exchange for

¹⁶² An interesting aspect of the Law on Pledge not necessarily related to residential mortgage transactions is the distinction the law makes between the registration obligations of corporate and commercial or "entrepreneurial" mortgagors and other mortgagors. See Law on Pledge, Art. 18. Corporate or commercial mortgagors bear the burden for timely and accurate mortgage registration and the attendant liability for registration errors, though it is unclear whether that liability extends to technical defects in registration as well as willful inaccuracies made with the intention to mislead or defraud. Apparently, these same provisions of the law do not apply to individual, non-commercial mortgagors.

The purpose of this distinction and the specific liabilities imposed on commercial mortgagors is unclear. Under the general principles of Russian contract law debtors would in any case be liable to the creditor for any deliberate misrepresentations in the mortgage transaction, or any deliberate interference with proper registration, and would remain liable for the underlying debt even if the mortgage document is defective. This provision of the law appears, then, to add little.

The law should perhaps leave determination of the responsibility for registration to the parties. The likely outcome under the circumstances would be that the professionals employed by creditors would take the responsibility, as it is the creditor who has the greatest interest in proper registration. Most creditors would rather rely on a properly completed mortgage transaction than a claim against a possibly insolvent debtor for registration errors.

something of real value? Will a mortgage registered despite a mortgagee's actual knowledge of some prior unregistered interest in the property have priority over that interest? Will a mortgage securing a loan to be advanced in installments have priority over all other secured claims arising between the date of the first and the final advances? In all these cases the law in most American jurisdictions provides an answer.¹⁶³ In Russia today these types of issues do not appear to be clearly addressed in the law. Such issues should perhaps be addressed as part of a general law dealing with registration of land titles, including mortgages.

One practical issue arising under the Law on Pledge is the requirement that mortgages be in notarial form. While the volume of new mortgage originations is small, this may not present a problem. However, as the volume increases the

¹⁶³ Many American jurisdictions have established by statute or common law that, as a condition of priority, registered real estate interests, including mortgages, must have been taken for value, in good faith, and without knowledge of other prior interests in the property. See 6A Powell on Real Property Ch. 82.

The apparent intention of the Law on Pledge is to deem any unregistered mortgage interest null and void, but mortgages are only one type of interest in real property. Other types of interests that may conflict with the rights of a mortgagee do not need to be registered under current law; documents of sale and leases are good examples. It is therefore quite possible for conflicts to arise between the rights of a registered mortgagee and the rights of a holder of some prior, unregistered interest in the property until there are general legal principles dealing with the registration and priorities of all interests in real property.

The direction of the Russian law at this time appears to emphasize the act of registration as the definitive issue in resolving conflicts between property interests. This is not necessarily inappropriate, and is in fact the approach used in some American jurisdictions and many other nations. See id. However, such systems have been known to give inadequate attention to basic issues of equity or fairness in resolving competing claims. See id., at Sec. 9.01 et seq.

role and availability of state notaries may cause a bottleneck in the loan origination process. The notarial system in the United States, for example, differs from that of Russia in that notaries are not civil servants, the role and professional training of notaries is considerably less, and there are, generally, many more notaries.

As a general recommendation, the role the state notariat plays in mortgage transactions should be reviewed in light of its likely impact on the costs and efficient completion of those transactions. Short of redesigning the Russian notarial system, it may be possible to enhance the efficiency of mortgage originations to allow the mortgage document to be certified by any licensed attorney. The attorney would be answerable to licensing authorities or under law for any abuse of the certification power.

B.4. Variable Rate Mortgages

Article 10 (1) of the Law on Pledge requires that the mortgage document describe the nature of the debt obligation and state the amount secured by the mortgage. It is likely that under present economic conditions in Russia the predominant form of mortgage loan will be the variable interest rate loan, under which the interest rate on the loan will be adjusted periodically. It is also possible that variations on the adjustable interest rate mortgage will be used under which portions of the interest due on the debt would be accrued and added to the amount of principal secured by the mortgage. In such cases, the actual interest rate on the loan cannot be described with specificity, or the "amount" of the underlying principle obligation of the debtor cannot be known at the inception of the loan, but rather may increase over time.

If the requirement that mortgage documents include the a description of the obligation and the amount of the debt is strictly interpreted, a mortgage that entails variable interest rates or capitalization of accrued interest may be

deficient in form and could be nullified. At the least, any amounts of increased interest or principal over the original amount of the loan could be unsecured or subject to the claims of subsequent creditors.

The law should stipulate that the interest rate and amount of the debt should be stated at the inception, but that the mortgage will not be deemed to be defective if the interest rate changes or interest is periodically accrued and added to the underlying principal obligation. The law should further specify that all such additional interest and principal will enjoy the same priority over subsequent creditors as the original amount of the loan.¹⁶⁴

B.5. Cooperatives

As a general principle, owners of rights to occupy apartments in cooperative apartment buildings should enjoy the same rights to finance their property as other residential property owners.

The Law on Pledge contemplates the pledge of stock or securities,¹⁶⁵ which presumably would allow the pledge of

¹⁶⁴ A typical law in the United States addressing this issue might provide as follows:

(a) A mortgage may secure an obligation on which the rate of interest may be changed from time to time in accordance with the agreement of the mortgagor and mortgagee, and the protection of the mortgage shall extend to all interest due and payable on such obligation.

(b) Any mortgagee may contract with a mortgagor in connection with a mortgage loan for the interest on such loan to be paid currently or to accrue, and, if such interest is to accrue, for such accrued interest to be added to the principle mortgage debtor which interest may be charged or collected. Such accrued interest which is added to the principal mortgage debt shall be secured by the mortgage to the same extent as the original principal of such mortgage debt.

¹⁶⁵ Law on Pledge, Art. 4 (2). It should be noted that in the American system the cooperative housing association

shares in a cooperative housing association, and allows owners of shares in a commonly shareheld property to pledge their interests without the consent of the other shareholders.¹⁶⁶ Presumably, the right to occupy an apartment in a cooperative building may also be pledged under Section IV of the Law on Pledge.

However, the Code of Civil Procedure prohibits execution on and sale of shares in cooperative associations if the judgement debtor has not been expelled from the association.¹⁶⁷ In addition, the Law on Ownership makes a legal distinction between the right of those who have fully

differs from other forms of residential real property ownership insofar as the entire property remains in the ownership of the cooperative association. Those with rights to occupy the apartments own an interest in the cooperative association, in the form of share certificates or otherwise, and the right to occupy their apartment pursuant to a lease or other right of occupancy. Mortgages taken to secure loans for cooperative apartments are not a mortgage on real estate, but rather a mortgage on the debtor's rights as a member of the cooperative, which by definition are personal property and not real estate.

Under the existing Russian law the form of legal ownership in cooperative housing associations is unclear. While the cooperatives themselves are shareholder associations, the Law on Ownership provides that those shareholders who have fully paid the subscription price of their shares acquire the "right of ownership" to the apartment. Law of Ownership, *supra* at note 8, at Article 13 (2). Presumably this means a right in real estate, and not just a right of ownership of the fully paid up shares. The significance of this distinction is that the apartment in a cooperative building could be mortgaged both as real estate and share rights in the cooperative association.

¹⁶⁶ Law on Pledge, Art. 7 (2).

¹⁶⁷ Code of Civil Procedure, Art. 369 and Schedule No. 1. This provision of the Code of Civil Procedure conflicts with the Law on Ownership by placing restrictions on the right to mortgage fully paid up share interests in cooperative associations. Its continuing validity is also in question if the Law on Ownership is interpreted to vest real estate rights, and not personal property rights, in the fully paid up owners of cooperative apartments. See discussion at note 166, *supra*.

paid shares and the rights of those whose shares are not fully paid, raising some question as to what those in the latter group actually own.¹⁶⁸ These provisions could affect the financing of apartments in cooperative buildings.

Such ambiguities can perhaps be dealt with by piecemeal amendment to the organizational documents of cooperative housing associations. For example, documents could explicitly provide that all members have the right to mortgage their interests in the association, whether or not their shares are fully paid, or to pay their shares in full with the proceeds of mortgage loans. They could further provide that the entry of a foreclosure judgement would automatically result in expulsion of the member from the cooperative association, clearing the way for a judgement creditor to obtain and sell the shares owned by the debtor.

However, if owners of apartments in cooperative or joint stock buildings are to be assured the same rights of financing an asset as the owners of other types of property, it may be necessary to consider clarifications to the law that specifically allow the pledge of share interests in a cooperative housing association or other form of shared ownership, and the distinctions, if any, between the rights of those with fully paid shares and others should be clarified. The law would further provide that the judgement creditor, upon obtaining ownership of the cooperative shares, would also have the right to demand from the cooperative association a transfer of the right to possession of the judgement debtor's apartment.

B.6. Termination of Mortgage

The Law on Pledge provides that the mortgage is deemed terminated upon destruction of the mortgaged property.¹⁶⁹ Presumably, upon destruction of the property the creditor

¹⁶⁸ Law on Ownership, supra at note 11, at Art. 13 (2).

¹⁶⁹ Law on Pledge, Art. 34 (2).

would be left with its right to insurance proceeds, as provided under Article 9 (3) of the law. However, this does not address a situation where the property, through some oversight of the mortgagor, is not insured, or where insurance proceeds are insufficient to compensate the creditor for all outstanding amounts.

If a building is destroyed, the real estate creditor should continue to hold a mortgage claim on the underlying land or right to its use until the debt has been repaid in full. This right, while perhaps not possible at the time the Law on Pledge was enacted, should be allowable under recent changes to rights of residential land ownership enacted under Article 12 to the Constitution.¹⁷⁰

B.7. Statement of Value

The Law on Pledge requires that mortgage documents include a statement of the value of the property.¹⁷¹ The purpose for this requirement should be clarified, as its relevance to real estate lending is doubtful.

Present Russian law requires that the real property be appraised by the court or the bailiff at the time of auction sale.¹⁷² Bidding at the initial public auction of the property is to start at the official valuation, and if there are no bids at that level the creditor has the right to take possession of the property with a credit at the official valuation, or to allow the property to be auctioned again without an initial starting price.¹⁷³

¹⁷⁰ Supra at note 4.

¹⁷¹ Law on Pledge, Article 10 (1).

¹⁷² Code of Civil Procedure, Arts. 200, 373.

¹⁷³ Code of Civil Procedure, Art. 404. In many American jurisdictions it is also not uncommon for a court to order that bidding in a foreclosure sale begin at a price specified by the court and based on reasonable evidence

While this system is a rational approach to protecting the interests of the debtor, it does not depend upon valuation of the property at the time the mortgage is made. Rather, as provided in the law, the value of the property is appraised at the time of sale.

There is no necessary relationship between the value of the property at the time the mortgage is made and at the time of sale in a foreclosure proceeding, and it is the latter time that is most significant for protecting the rights of the parties. Under the United States legal system, for example, property values are not included in real estate mortgages.

To prevent conflict between this provision of the law and the requirement of the Code of Civil Procedure that a valuation be made at the time of sale, the law should delete the requirement of a property valuation in real estate mortgages, or clarify the purpose of such valuation.

C. CODE OF CIVIL PROCEDURE

C.1. Discretion of the Court

Under Article 207 of the Code of Civil Procedure the court is empowered "on the application of the persons taking part in the case, in view of the financial condition of the parties or other circumstances, to defer satisfaction of judgement or order satisfaction of judgement by installments, as well as altering the method of execution and the procedure for execution." As the Code of Civil Procedure is a law of general applicability in civil actions, presumably this provision applies in actions to collect mortgage debts. Drafts of further laws on real estate mortgages provided to the author by working groups of the Supreme Soviet do in fact seek to incorporate the

before the court as to the value of the property at the time of sale. See 55 Am. Jur. 2d Mortgages Sec. 662 (1971).

principle set out in Article 207 directly into the substantive law of mortgage.¹⁷⁴

On its face, this provision of the law gives to the court broad discretion to grant extended grace periods, or even restructure debt obligations, depending upon the financial condition of the debtor "or other circumstances." Guidelines are not provided to constrain the court's discretion, though there may be a history of interpretation of this provision in Russian courts.¹⁷⁵

While it is an often stated legal axiom that under American and British common law legal systems a mortgage foreclosure is an equitable action in which the courts have broad discretion, legal precedent has narrowed the range of expectations; rarely does a court seek to reinterpret the underlying contractual obligation to take into account the financial condition of the debtor "or other circumstances."

The principle embodied in Article 207 creates uncertainty in the foreclosure process and, therefore, greater risk to creditors, and unless the broad discretion

¹⁷⁴ An early version of the Draft Law on Mortgage (supra at note 11) provided to the author in October, 1992 provided that "(t)he court or arbitration court can stretch out the repayment of the debt on the security of the mortgage, due to actual circumstances, up to three years." On its face, this appeared to permit a recasting of the debt over an additional three year term, which would result in lower payments to the debtor, but the actual intention was unclear. A similar provision has been included in the Draft Law on Mortgage, supra at note 11.

¹⁷⁵ The success of residential mortgage finance may depend in the short run on the general attitudes of Russian society toward the concept of foreclosure, which attitudes may be reflected in the judgements of the courts. Most Russians, including lawyers, with whom the author has discussed the American concept and practice of residential foreclosure express frank incredulity that people are actually turned out of their homes, as in Russia the remedy of eviction from residential property is rarely used and subject to significant legal restrictions. See, for example, Fundamentals of the Housing Legislation of the USSR and the Union Republics, June 24, 1981, Arts. 36-38.

implied in the law is constrained it could lead to higher borrowing costs and a serious disincentive to mortgage lending. At the least, if Article 207 or some variant is to be preserved, there should be clarification of the scope of the court's discretion.

Some American jurisdictions have from time to time enacted laws similar to Article 207, which give the court discretion to order a period of forbearance and a restructuring of the underlying mortgage debt in specific circumstances. The Connecticut law,¹⁷⁶ for example, attempts to deal with the problem of temporary financial reversals caused by unemployment of the primary breadwinner. However, that law is subject to many detailed constraints on the court's discretion, including the following:

- (a) that the home be the debtor's primary residence;
- (b) that the court must determine that there is a reasonable expectation that the debtor will be able to begin repaying the loan at the end of the court ordered forbearance period;
- (c) that the court must consider any harm to the creditor from the ordered forbearance and restructuring of the loan;
- (d) that the period of forbearance not exceed 6 months;
- (e) that during the period of forbearance the debtor make "good faith" payments on the loan not to exceed 25% of his net income;
- (f) that the court must restructure the loan so that at the expiration of the forbearance period the unpaid interest and all of the creditor's costs are added to the principle balance of the loan and repaid by the debtor over the remaining term of the loan.
- (g) that the debtor cannot take advantage of this law more than once in every seven years.

¹⁷⁶ Conn. Gen. Stat. Ann. Sec. 49-31d et seq.

Any judicial constraints on the right to foreclose might increase risk and, therefore, the cost of borrowing. However, if such constraints are to be enacted or, as expressed in Article 207, continued in effect, some effort should be made to define and constrain the scope of the court's discretion.

C.2. Rights to Notice and Cure

As stated at the outset, it is a premise of this paper that one of the best protections provided to debtors is the right to notice and a period of time to cure a default before significant legal consequences occur. The debtor thereby has the option to cure defaults or otherwise deal with his financial problems through refinancing or sale of the property.

Under present Russian law debtors are not given explicit statutory rights to notice of default and a specified time to cure before the foreclosure proceeding is commenced. There are, however, some similar protections. For example, the typical procedure for commencement of a suit appears to be a preliminary hearing in which the defendant may be summoned to be apprised by the court of the nature of the claims and his rights and obligations.¹⁷⁷ In addition, prior to conducting an auction sale the bailiff must give a debt 5 days written notice to comply with the judgement on the debt¹⁷⁸ and there is a statutory 30 day right of redemption.¹⁷⁹

Additional statutory notice periods might be considered to protect the unwary debtor and to provide greater certainty in the process. Notice could be provided to the debtor at two points in the process, the first being notice

¹⁷⁷ Code of Civil Procedure, Art. 141.

¹⁷⁸ Code of Civil Procedure, Art. 356.

¹⁷⁹ Code of Civil Procedure, Art. 398.

of the creditor's intention to accelerate the debt and commence foreclosure proceedings, and the second prior to the actual execution sale. In each case the statute should provide for the content of the required notice, the manner of serving notice, and the time periods for curative action by the debtor.¹⁸⁰

¹⁸⁰ The ULSIA, supra at note 133, provides pertinent notice provisions as follows:

Section 502. Acceleration.

(a) To exercise a right to accelerate against a debtor, a creditor must give written notice after the debtor's failure to perform that if the failure is not cured before a date stated, which may not be earlier than 15 days after the date the notice is given, or in any event earlier than the expiration of the grace period in the security agreement, the entire debt will be due. This provision may be waived or modified by a debtor other than a [home owner].

...

Section 506. Index of Notices and times Relating to Foreclosure.

(a) Before foreclosure, a notice of intention to foreclose (Section 508) must be given. The content of the notice is specified in Section 508 (b), the method of sending by Section 508 (a), and the persons to whom it must be sent by Section 507 (f). If, at the time of default, the real estate is occupied by a [home owner] or an individual related to the [home owner], the notice of intention to foreclose may not be given until the time specified in Section 507 (d). Except as specified as to a [home owner] in Section 507 (d), the notice of intention to foreclose may be sent at any time after default.

...

Section 507. Methods of foreclosure and Notice.

...

(b) Absent agreement, but after giving the debtor notice of an intention to foreclose (Section 508), the secured creditor may terminate the debtor's interest in the real estate by judicial sale..., but as against a [home owner] the judicial proceeding may not be commenced until 5 weeks after notice of the intention to commence the proceeding has been given.

...

(d) If at the time of default a dwelling unit in the real estate is occupied as a residence by a [home owner] or an individual related to the [home owner], the notice of intention to foreclose may not be given until a payment of money has not been paid when due and remains unpaid for 5 or more weeks or until the [home owner], having been notified by the secured creditor to cure any other default under the security agreement, has failed to commence and proceed diligently with performance within 5 weeks.

...

(f) A notice of intention to foreclose required by this section must be sent to the person specified by the debtor in the security agreement or, if none is specified, to the debtor or any one of two or more debtors, but notice must be given to all debtors having an interest in the property who are [home owners], to any person obligated on the debt whom the creditor may wish to hold liable for any deficiency, and to any person in possession of the real estate from whom the creditor has received a written demand to receive notice of an intention to foreclose. Failure to comply with this subsection does not invalidate the notice as to persons to whom it is given.

Section 508. Notice of Intention to Foreclose.

(a) Notice of intention to foreclose in writing complying with subsection (b) must be sent to the person entitled thereto both by registered or certified mail and by ordinary first class mail. The notice must be sent to the debtor at the debtor's address specified in the security agreement as the place to which notices are to be sent. If the creditor knows of a different address of the debtor at which notices are more likely to come to the debtor's attention, the notice also must be sent to that address. The notice must be sent to a person other than a debtor at any address at which the secured party in good faith believes the notice is likely to come to the person's attention.

(b) The writing must state in a manner calculated to make the debtor aware of the situation:

- (1) the particular security interest to be foreclosed;
- (2) the nature of the default claimed;
- (3) that the secured creditor has accelerated maturity of the debt, if that is the case;

C.3. Stays and Appeals

Under the Code of Civil Procedure a foreclosure proceeding may be challenged or appealed at several points in the process. The debtor may defend the claim in the court of original jurisdiction, and the final judgement may be appealed by the parties within 10 days of entry.¹⁸¹

Depending upon whether there is an intermediate court of appeals in the jurisdiction, appeals must be heard and decided in the intermediate appeals courts within 10 days of receipt, or 20 days in extraordinary circumstances.¹⁸² The Supreme Court of the RSFSR has 30 days from receipt to hear and decide an appeal, and 60 days in extraordinary circumstances.¹⁸³ Whether these time constraints on

(4) any right the debtor has to cure the default, the amount to be paid or other action necessary to cure, and the time within which the cure must take place;

(5) the methods by which the debtor's ownership of the real estate may be terminated;

(6) any right the debtor has to transfer the real estate to another person subject to the security interest or to refinance the obligation and of the transferee's right, if any, to succeed to the rights of the debtor in curing the default;

(7) the circumstances under which the debtor's right to possession will be terminated and that on termination the debtor may be evicted by judicial process;

(8) the right of the debtor to any surplus from a sale and, if the debtor is or may be held liable for a deficiency, a statement of the circumstances under which the deficiency will be asserted;

(9) that no deficiency may or will be claimed if that is the case;

(10) if the secured creditor intends to include in the notice of intention to foreclose notice of sale under a power of sale..., or of intention to institute judicial proceedings..., the creditor shall so state... ; and

(11) the right of the debtor under [this law] to apply for a court order controlling the foreclosure.

181 Code of Civil procedure, Art. 284.

182 Code of Civil Procedure, Art. 284-1.

completion of appeals can continue to be met in the face of expanding commercial legal rights and substantial new demands on the Russian judicial system, including increasing involvement and responsibilities of the Supreme Court, will remain to be seen.

In addition to appeals of judgements, a debtor may file an appeal with the court of original jurisdiction challenging the auction proceeding or an action of the bailiff in the property auction.¹⁸⁴ Such appeals must be filed within 10 days of the date of the offending act or of the date that an interested person not having prior notice of the time and place of the act first became aware of it.¹⁸⁵

Finally, the Code of Civil Procedure permits all decisions of Russian Courts to be reopened and reviewed by the Civil Chamber of the Supreme Court or the Supreme Courts of autonomous republics at any time upon application of designated officials, including the Office of the RSFSR Procurator General or his deputies or the Presidents of the Presidiums of the Supreme Courts of the RSFSR and the autonomous republics.¹⁸⁶ Whether this provision of the law would be applied in minor commercial cases such as real estate foreclosures remains to be seen.

Rights to appeal foreclosure judgements are necessary and appropriate. However, such rights raise issues to the extent that, through stays of execution pending appeal, they may delay realization of the value of the security. Delays of execution affect secured creditors in several ways. First, assuming that the judgement remains open to include interest that accrues pending completion of the appeal, the

183 Id.

184 Code of Civil procedure, Art. 428.

185 Id.

186 Code of Civil Procedure, Art. 319

creditor is risking further losses to the extent that the value of the property is insufficient and the debtor, who is almost by definition in financial difficulty, cannot pay the accruing interest through a deficiency judgement. Second, a property in foreclosure tends to be in greater risk of deterioration through lack of maintenance or vandalism, and this risk increases the longer the execution is postponed.

These issues may be addressed in several ways. The first is by clarifying and limiting the circumstances under which a court may stay an execution sale pending appeal. The present Russian law covering stay of execution requires that a stay be issued in a variety of circumstances, -- including, for example, the debtor's active service in the armed forces or loss of "dispositive capacity" -- that are essentially irrelevant to the credit transaction.¹⁸⁷ Execution must also be stayed if there is a challenge to the attachment or an appeal of administrative procedure. Courts have discretion to stay execution in another set of circumstances, including active military service or a challenge to the documents of execution.¹⁸⁸

To provide greater certainty in the process, the existing Russian law might be reviewed and modified or clarified to the extent necessary to achieve several objectives. First, court discretion to stay foreclosure sale should be limited to those circumstances in which there is a challenge to the legitimacy of the foreclosure itself. The personal circumstances of the debtor at the time of the foreclosure, while they may occasionally be unfortunate, should not be a relevant consideration and are not among the risks for which private sector creditors bargain. In any

¹⁸⁷ Code of Civil procedure, Art. 361; see also note 129, supra.

¹⁸⁸ Code of Civil Procedure, Art 362; see also note 130, supra.

event, such circumstances may often be adequately addressed under a law of personal bankruptcy.

Stays pending challenges to foreclosure judgements should be discretionary with the court, not mandatory in any circumstances, and should be limited to those circumstances in which (1) there is a substantial likelihood that the defendant will succeed in his appeal; and (2) there is no likelihood of serious prejudice to the creditor from delay or the creditor can be adequately protected against damages.¹⁸⁹

Those requesting a stay of execution pending appeal may be required to provide a bond or other financial security, in an amount set by the court, protecting the creditor against potential losses caused by delay.¹⁹⁰ The inability of a debtor to post such a bond or other financial security should be a factor in the court's determination of whether the creditor is adequately protected against further losses.

Finally, stays pending challenges to the behavior of the bailiff or other auction sale proceeding should be granted only where there are clear indications of fraud or unfairness that would result in real prejudice to the debtor, and not for mere technical defects. Further, stay of execution sale must be based on a defect in the process

¹⁸⁹ This approach is probably not significantly different than the policy objectives expressed in Article 211 of the Code of Civil Procedure, which allows expedited sales of property, which may not be stayed pending appeal of the judgement, and which may be based on the likelihood of prejudice to the rights of the creditor.

¹⁹⁰ The appeal or "supersedeas" bond is a standard practice of the American legal system. The Russian Code of Civil Procedure may include the foundations for an appeal bond under Articles 133 and 134, which allow the court to "take security for an action" at any stage of the proceedings in circumstances in which failure to do so may make it difficult to carry out the court's judgement. While Article 134 does not explicitly mention bonds or the taking of other types of financial security, it does allow attachment of money or other property.

itself, and not on general arguments of unfairness such as a bad time to sell property in the market.

C.4. The Consequences of Foreclosure: The Rights of Third Parties

In any case of foreclosure there may be persons, other than the debtor and creditor, who have interests in the property, including, for example, lessees, second mortgagees and guarantors of the mortgage debt. Presumably, these parties may be identified in the preliminary hearing of an action called for under Article 141 of the Code of Civil Procedure and joined in the action to assert and defend their interests.

The object of the foreclosure proceeding is to clear all adverse interests in the property so that it can be sold at the highest possible price at an auction sale. To the extent that interests in the property are not entirely resolved and foreclosed prior to auction, the value of the property and the proceeds of sale will likely be diminished.

The existing law makes clear that the rights of a first mortgagee in foreclosure are paramount to all other secured interests in the property, and that the first mortgagee is obligated to junior interests only to the extent that there are sale proceeds remaining after the payment in full of costs and the first mortgage debt. With respect to the typical auction sale, then, the termination of the interests of junior creditors is clear. However, there may be certain situations that are not contemplated in the law.

What, for example, are the rights of a junior creditor or other interested party who inadvertently is not notified of a foreclosure proceeding and execution sale and therefore does not have the opportunity to assert and defend his interests? Does the judgment and sale nevertheless terminate his interest in the property?¹⁹¹

As a general rule, it may be necessary to establish that notification of the proceeding is necessary to terminate the rights of any person by foreclosure judgement. However, in the event that notice is not given to an interested party, either the creditor or the purchaser at the foreclosure sale should have an opportunity to resolve the situation by subsequent foreclosure proceeding or the right to demand that the omitted party redeem the property from the mortgagee for the full amount of the first mortgage debt or the auction purchase price, including interest and costs.

Similarly, the rights of lessees of foreclosed property are unclear. As a general rule, leases existing at the time the mortgage is made and of which the creditor is aware should not be terminated by the foreclosure. Leases that are made after the date of the mortgage, like other interests in the property, should be terminated by the foreclosure judgement.

The rights of the parties may also depend upon how the creditor realizes the security. For example, if the law eventually permits sale by notarial action, negotiated

191 Under the Code of Civil Procedure it seems clear that service of process is a necessary prerequisite to adjudication of the rights of an interested party and that an action may not proceed in the absence of an interested party whose whereabouts are known without evidence that such party has been served with a writ or summons. See Code of Civil Procedure, Arts. 106, 157. However, this provision does not address several issues in mortgage foreclosure proceedings, including the existence of undisclosed or undiscovered interested parties and the result when such parties come forward after completion of the proceedings.

In addition, Art 429 of the Code of Civil Procedure seems to provide that third parties having an interest in the property may bring an action for release of the property from attachment, and that if such actions are brought after completion of the auction sale, the auction purchaser must be joined in the action. However, this provision does not address the rights or options of the mortgagee or bona fide purchaser in the face of such a challenge by an interested party.

transfer of title, or private sale, will such proceedings have the effect of terminating all third party rights in the property, or will termination occur only in judicially supervised proceedings?

The point here is that the rights of third parties in foreclosure proceedings can be complex, and many potential issues are either not addressed or only vaguely addressed in the existing Russian law. Regardless of what additional rules are devised for resolving third party interests in foreclosed property, the law should strive to assure that upon finality of the foreclosure judgement, all other rights of interested parties, including junior liens, are terminated, or are subject to termination through further proceedings, and that the mortgagee and bona fide purchaser obtain title to the property free and clear of all adverse interests junior to the interest of the foreclosing creditor.¹⁹²

C.5. The Consequences of Foreclosure: The Rights of Bona Fide Purchasers

As a general principle, it is in the interests of both the creditor and debtor to achieve the highest possible price for a property in foreclosure; the debtor because he may be liable for any deficiency in the value of the property, and the creditor because he is left with an unsecured claim against a debtor experiencing financial

¹⁹² The ULSIA, supra at note 133, provides an illustrative statutory provision as follows:

Section 512. Effect of Disposition

(a) If real estate is sold by a creditor under a power of sale...or at a judicial sale..., a purchaser for value in good faith acquires the debtor's and creditors rights in the real estate, free of the security interest under which the sale occurred and any subordinate interest, even though the creditor or person conducting the sale fails to comply with the requirements of this [law] on default or of any judicial sale proceeding.

difficulties. Following that principle, it should be the purpose of the law to insure that the procedures for execution and sale of mortgaged property result in the highest possible price. This is achieved in the first instance by permitting the auction sale of the property, and by requiring reasonable publication of the auction sale to induce the greatest competitive interest.

Another important means of assuring the value of the property in foreclosure is to enhance the quality of the title taken by those who acquire the property in the foreclosure sale. Ownership rights that may be subject to challenge or rescission at some time after sale, considering the expense and effort the successful bidder may put into the property, will result in a lower purchase price to account for the increased risk. Further, the possibility of rescission of the sale at a time considerably after its completion serves as a disincentive for purchasers to improve the property.

Under the present Russian law, if a judgement is set aside on appeal by a higher court, or remanded for new trial in which the judgement is ultimately set aside, either court has the right to set aside the execution sale as well.¹⁹³ If the execution sale is set aside, "everything which was taken from the defendant for the benefit of the plaintiff must be returned to him."¹⁹⁴

Article 405 of the Code of Civil Procedure further declares that until three years following its date, the

¹⁹³ Code of Civil Procedure, Chapter 42.

¹⁹⁴ Code of Civil Procedure, Art. 430. It should be noted that the Civil Code recognizes the concept of a bona fide purchaser at execution sale, and that such purchasers take the property free of certain claims of the property owner regarding the improper possession and pledge of the property by one unauthorized to do so. See Civil Code, Art. 152. Article 152 does not, however, address the issue of procedural defects in the execution sale, which is the more common issue in foreclosure proceedings.

court may declare any auction sale invalid "if it was conducted in violation of the established rules...and also in the event of the commission of malpractice by the bailiff, judgement creditor, or buyer [at the auction sale]." The courts judgement on such challenges are also appealable to a higher court.¹⁹⁵ If a challenge to the auction is made by the debtor or other authorized party after the actual sale of the property, the auction purchaser must be made a party to the action.¹⁹⁶

The many possibilities of rescinding completed foreclosure sales could have a detrimental effect on the price received for the property, and could therefore be counterproductive. The ULSIA takes the position that once completed, foreclosure sales may not be rescinded and the title obtained by the bona fide purchaser is protected under all circumstances. Admittedly, however, the position of the ULSIA is not the general rule in American jurisdictions.

Under the law of most American jurisdictions, rescission of completed foreclosure sales is possible, but generally only in instances where there is clear indication of fraud or gross unfairness that resulted in material prejudice to the rights of the debtor.¹⁹⁷ Minor irregularities in procedure or disagreements with the time place or manner of the sale that do not result in clear prejudice to the debtor are not grounds for rescission.¹⁹⁸ Also, as a general rule, challenges or issues that could have been raised by an interested party in the foreclosure proceeding or prior to completion of sale are not allowed in an action for rescission of a sale.¹⁹⁹

195 Id.

196 Code of Civil Procedure, Art. 429.

197 See 55 Am. Jur. 2d Mortgages Secs. 670-673; 773 (1971).

198 Id.

It has been suggested in this paper that the object of the law should be to provide to the debtor all reasonable opportunities, through notice and cure periods, to contest an action in the courts prior to the time of actual completion of a sale transaction. The court also should have the discretion to stay or restrain sales or distribution of proceeds prior to completion if the debtor's claims appear to have merit. The corollary principle to these, however, is that once completed, the sale of the property should be final and the debtor's recourse should be to damages against the creditor or other offending party.

Short of adopting this recommendation, it might be worthwhile to consider further limiting the time period in which irregularities in the foreclosure process may result in rescinding the sale, say from the 3 years presently set out in the Code of Civil Procedure to one year, and exempting real estate foreclosure transactions from the court of review process set out in Chapter 36 of the Code of Civil Procedure. In addition, the law should make clear that sales are not to be rescinded except in cases of (1) essential invalidity of the mortgage or debt, (2) clear evidence of fraud or gross unfairness, and (3) real harm to the debtor.

If foreclosure sales are to be rescinded after the sale is completed, the law might also address the rights of the bona fide purchaser under such conditions. One solution is to place the bona fide purchaser in the position of the creditor before the foreclosure sale, in effect granting him a statutory mortgage on the property. The general rule in American jurisdictions is that the purchaser may then retain possession of the property until the debtor redeems the property by paying the full amount of the purchase price, accrued interest and costs, and, in some jurisdictions, for the value of any improvements to the property.²⁰⁰

¹⁹⁹ Id., at Sec. 670.

C.6. Mortgagees' Rights to Bid

In the event a foreclosure auction sale is nullified under the Code of Civil Procedure for insufficient number of bidders or failure to achieve the official starting bid price, the mortgagee may opt to take possession of the property at the official valuation.²⁰¹ At a second auction sale there is no official starting price, and if it fails the mortgagee is required to take the property at the official valuation under penalty of having the mortgage terminated.²⁰²

While the question of whether the mortgagee has the right to enter a bid in any foreclosure sale is not specifically addressed, the rights given to the mortgagee to take possession of the property under the Code of Civil procedure should be viewed as exclusive, and mortgagee bids are therefore not permitted. This conclusion is reinforced in the Draft Law on Mortgage, which specifically prohibits mortgagees from bidding at foreclosure sales.²⁰³

Provided that the starting bid prices at initial auction sales are fair and accurate, and that the mortgagee has the right to challenge them if they are not, mortgagee bid rights are not essential to the effectiveness of the system.²⁰⁴ However, in a sale at which there is no official

200 Id., at Secs. 824-830.

201 Code of Civil Procedure, Art. 404.

202 Id.

203 Supra at note 11.

204 Obvious differences between the Russian law and the law of most American jurisdictions is that in the latter minimum bid prices are not required in foreclosure sales, though they may often be imposed at the discretion of a court, and mortgagees are generally entitled to enter bids. The upshot is that under American law the mortgagee may, and frequently does, obtain possession of the property for the amount of the mortgage loan, wiping out any equity of the debtor. By requiring an official valuation, the Russian law may prevent

starting price, which would occur if the first sale fails for the reasons specified in the law, the mortgagee could be harmed if the bids made are significantly lower than the amounts due under the mortgage and the debtor is insolvent and unable to pay a deficiency judgement.²⁰⁵

A mortgagee's interests could perhaps be better protected by requiring that the starting price in any initial auction sale be set at not less than the amount of the claim under the mortgage, and that the mortgagee should be able to enter a final bid at any subsequent sale in which there is no valuation set by agreement of the parties or by a court of law.

D. BORROWER PROTECTION

D.1. Purposes of Disclosure

In the following discussion "disclosure" is a general term for all written information provided to the prospective debtor from the time he applies for the mortgage loan through the time the loan transaction is completed. It may include descriptions of the debtor's legal rights and obligations during the application process and after the loan is issued, as well as detailed descriptions of the terms of the loan for which the debtor is applying. Disclosure requirements in residential mortgage loan

this from occurring, as the mortgagee would have to pay the full value of the property, only a portion of which may be offset by the mortgage debt. While this approach departs from the general American practice, and imposes somewhat greater costs and risks on lenders, it cannot be said to be inherently unfair or inefficient.

²⁰⁵ The Draft Law on Mortgage, supra at note 11, provides that the initial starting price in the first auction sale will be set by agreement of the parties or by the court upon application of either of the parties. In the second auction sale it would be set by the independent auctioneers conducting the sale. See note 157, supra. Generally, it is in the interests of independent auctioneers to move the product, and it will be priced accordingly; this may conflict with the interests of both of the parties to the mortgage.

transactions can be imposed on creditors by law, as they are in the United States.²⁰⁶

Legal requirements for residential mortgage loan disclosure are important for several reasons. From the debtor's perspective, disclosure protects him from unfair or fraudulent practices by creditors. In addition, considering that the residential mortgage loan is a relatively unknown product in Russia, debtors may need basic education on the basic principles of mortgage lending.

Creditors should be concerned because Russian contract law allows nullification of contracts for fraud, misrepresentation, and false pretenses.²⁰⁷ In complex financial transactions such as mortgage loans, which generally involve average working people and not sophisticated businessmen, the possibility of allegations of fraud or misrepresentation made against lending institutions may be particularly high in Russia today. This risk may be lessened by a program of adequate written disclosure to prospective debtors. If the disclosure is required as a matter of law, creditors also would have some guidelines to know when disclosure practice is legally sufficient.

The Code of Civil Procedure and recent proposals concerning Russian mortgage law also suggest that under certain circumstances the courts have the discretion to restructure or defer enforcement of a mortgage loan.²⁰⁸ It is generally in the nature of courts to use their powers on behalf of persons whom they think were poorly advised or manipulated by more sophisticated business organizations.

²⁰⁶ See, for example, Truth In Lending Act, 15 U.S.C. 1601 et seq.; Real Estate Settlement Procedures Act, 12 U.S.C. 2601 et seq.

²⁰⁷ See notes 23-26, supra, and accompanying text.

²⁰⁸ Code of Civil procedure, Art. 207. See also the discussion under Section II.C.1, supra.

Evidence of an appropriate disclosure program could help to avoid the appearance of unfair dealing.

Responsible creditors should recognize also that absolutely open dealing serves to distinguish them from those that do not adhere to such high standards, and that adequate disclosure might tend to decrease the amount of time and trouble in the servicing phase of the loan.

Finally, the availability of full information serves to facilitate markets. In the event that several types of mortgage products are available in the market, each tailored to the needs of debtors in certain economic circumstances, disclosure requirements helps to properly place the debtor in the loan that he is best able to support given his economic circumstances. It is against the interests of all parties -- debtors, creditors, and, ultimately, the state as guarantor of the solvency of the financial system -- to have debtors taking loans that they do not fully understand and which they may not be able to afford.

D.2. Legal Requirements

The main areas of disclosure are (1) description of the loan process and the rights and obligations that may arise, (2) description of the costs to the debtor for issuance of the loan, and (3) description of the debtors continuing costs, rights and obligations once the loan transaction has been completed. The process of disclosure generally assumes that the creditor's prospective debtor's are totally uninformed about the legal and financial aspects of the requested mortgage loan and must be educated with the material provided by the bank. At this point in the development of Russian residential mortgage lending, perhaps no concept is too basic to be overlooked.

As a starting point, a simple law might include the following:

- (1) All creditors authorized to make residential mortgage loans should provide basic disclosure

information to debtors at the time of application for the loan, and any changes or modifications to the disclosure not less than 5 days prior to execution of the loan documents.

(2) Required disclosure should include a statement that the debtor has the right to be represented by an attorney in connection with the mortgage loan and that the mortgage loan may have meaning and effects that are perhaps best understood with the advice of an attorney.²⁰⁹

(3) Disclosure should include an explanation of the interest to be paid by the debtor on the loan, including the effects of any interest adjustment formula. The creditor should provide to the debtor in clear and concise fashion an example of how the adjustment formula would be applied under assumed economic conditions, which assumptions should be reasonable and convey to the debtor the potential risks involved with his loan.

(4) Disclosure should identify all terms of the applicable interest adjustment formula, including: formulation of the adjustment index; the times at which the interest rate may be changed; by example, the effect of such changes on the debtors required payment; changes to the length (maturity) of the loan, if any; and such other matters associated with interest adjustment that may affect the amount or term of the debtor's obligation.

(5) An explanation, in plain language, should be given of the remaining conditions of the mortgage loan, with specific attention to the continuing obligations of the debtor under the loan and the rights of the mortgagee to accelerate the loan and foreclose the mortgage.

²⁰⁹ But see the discussion at note 156, *supra*, regarding the availability of legal assistance.

(6) An explanation should be given of all other fees and charges of any kind that will be collected from the debtor by the creditor making the mortgage loan. Included among the legal documents at execution of the loan should be an accounting of the sources and uses of all money to be exchanged between the debtor and creditor and other parties to the transaction.

(7) The disclosure requirements would be enforceable against violators in a court of law through penalties and fines assessed against the offending creditor.

E. NEGOTIABLE DEBT INSTRUMENTS

E.1. The Concept of Negotiability

The question of whether Russia needs to further develop its law of negotiable financial instruments in order to encourage residential mortgage lending is difficult to address. Whether further development of such laws is necessary for other aspects of Russia's developing market economy is beyond the scope of this paper.

A law of negotiable debt instruments affecting residential mortgage transactions becomes an issue only when it is expected that real estate debts and mortgages will in fact be transferred. Aside from the occasional transfer of mortgages between financial institutions, or perhaps the occasional transfer of a purchase-money obligation and mortgage from an individual property seller to a lending institution, negotiability is a concept primarily affecting systems in which there are significant secondary mortgage markets.

The benefit of negotiability is that the transferee has the opportunity to take the debt obligation free of many of the defenses to enforcement that the debtor could assert against the original creditor.²¹⁰ As a condition of

obtaining that benefit, the transferee must meet certain requirements, which include generally that he take the instrument in good faith and without the intention to deceive or defraud, for good value, and without actual notice of a claim or defense or cause to investigate the possibility of a claim or defense. Upon meeting these tests, the transferee of a negotiable instrument becomes, in the terminology of the American law, a "holder in due course" of the debt obligation, which is a protected status.²¹¹

210 The term "negotiability" refers to the formal characteristics of a debt instrument that are the necessary conditions for it to be transferred to a new owner free of any claims or defenses of the debtor or any other party claiming an interest in the instrument. Under the American Uniform Commercial Code, for example, an instrument is negotiable if it is an unconditional promise or order to pay a fixed amount of money, with or without interest, and is (1) payable to bearer or order, (2) payable on demand or at a definite time, and (3) does not state any other condition on or instruction regarding the promise to pay the money. See Uniform Commercial Code, Revised Article 3, Sec. 3-104.

211 The provisions of Section 3-302 of the Revised Article 3 of the American Uniform Commercial Code require the following for a transferee to acquire the status of a protected holder:

Section 3-302. Holder In Due Course.

(a) ... (H)older in due course" means the holder of an [debt] instrument if:

(1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument as part of the same series, (iv) without notice that the instrument contains any unauthorized signature or has been altered, (v) without notice of any claim to the instrument... , and (vi) without notice that any party has a defense or claim...

Once characterized as a protected holder, the transferee of the debt instrument is immune from the claims of any other party claiming an ownership interest in the debt instrument, as well as from most claims or defenses of the debtor to enforcement of the obligation. The transferee is immune from all claims and defenses other than those that may render the transaction a nullity from its inception, such as the infancy or other legal incapacity of the debtor, bankruptcy, duress or other inherent illegality, or "fraud that induced the debtor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or essential terms".²¹²

The general rule under American law is that the transferee of a negotiable obligation secured by a mortgage enjoys the same immunities with respect to claims or defenses to the mortgage as he does with regard to the underlying debt.²¹³ Thus, the benefit for mortgage creditors of the rules of negotiability are obvious. Mortgage investors can purchase loans from local banks and other financial institutions that originate the loans without fear that they are subject to a variety of undisclosed contractual defenses against the debt.

E.2. Russian Law

As discussed above,²¹⁴ Russian law presently (1) recognizes loan agreements;²¹⁵ (2) allows debt obligations

²¹² Uniform Commercial Code, Revised Article 3, Sec. 3-305.

²¹³ See 55 Am. Jur. 2d Mortgages Sec. 1308 (1971). Under the American Uniform Commercial Code the typical mortgage document is not a negotiable instrument because it does not meet the formal requisites. Accordingly, the typical practice is to have a debtor sign both a promissory note and a mortgage document. The note is negotiable, and invests the mortgage document with the benefits of negotiability under the code. Id.

and the rights to the accompanying security to be assigned by a creditor; (3) addresses the rights of guarantors of financial obligations; (4) establishes some limitations on defenses that may be made against the rights of bona fide transferees of financial obligations; and (5) establishes recourse transfers as a statutory presumption between transferors and transferees, which presumption may perhaps be modified by agreement.²¹⁶

While not the extensive laws of negotiable instruments of the United States and Europe, these basic provisions should support a Russian mortgage lending industry in the short run. However, it may be argued that a nation of 150,000,000 people, with a relatively low level of personal savings and a newly created private banking industry, is unlikely to develop an effective mortgage lending system without substantial private or publicly sponsored secondary market operations to assist in the mobilization of savings and the allocation of mortgage capital throughout the country.

The development of such secondary market institutions does not necessarily assume the negotiability of financial instruments and many of the protections provided to bona fide purchasers of those instruments under, for example, Article 3 of the United States Uniform Commercial Code. For example, as provided under existing Russian law, secondary market purchasers could simply purchase loans with full recourse against the sellers of the loans, which is not unusual even in the American system.²¹⁷ Nevertheless, a law

²¹⁴ See the discussion under Section I.C.3, *supra*.

²¹⁵ The Fundamentals of Civil Legislation explicitly recognize promissory notes as debt securities, but do not address the issue of negotiability. See Fundamentals of Civil Legislation, Art. 35.

²¹⁶ See *supra* note 40.

²¹⁷ It may be noted that in the short run it is likely for the primary mortgage lenders in Russia to be relatively

of negotiable instruments could add a higher degree of assurance and protection to the process and may deserve some attention.

III. CONCLUSION

The existing Russian law of real property mortgages may support a small mortgage lending industry in the short run, though much remains to be seen in how the law is interpreted and applied. Even so, the law may be improved by attention to certain crucial areas that affect the potential costs and risks of mortgage creditors. Such attention would be essential over the longer run if the mortgage lending industry is to achieve the volume of activity necessary to serve a country of Russia's size.

Significantly, many of the issues arising under the existing Russian law relate to the civil procedure. After all, the enforcement of secured interests is essentially a procedural matter, and it is in the procedural aspects of the law that the greatest risks and costs are encountered by creditors. The procedural aspects of the Russian law as they relate to mortgage lending deserve considerable attention and coordination with the developing substantive law of mortgages.

Protection for debtors also may be improved by modifications to the existing law, particularly with respect to the type of information required to be provided to debtors before the residential loan transaction is completed

established and responsible banking institutions, such as the former state savings bank and other formerly state owned banks that are now private commercial institutions. There can probably therefore be some reliance on both the quality of loan underwriting and that a recourse purchase from the originating institution is supported by assets in the event the defective loan is put back for repurchase.

and in the event of attempted enforcement of the creditor's rights under the mortgage.

The laws appear to be burdened by considerable ambiguity and apparent contradiction among laws. Much may perhaps be achieved through clarification of the intention of the laws and the relationships among the various provisions of the laws.