

Overcoming Legal Issues in Financing the Production of Crops in Russia

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Executive Summary

There is a working system for international grain traders to lend funds to agricultural producers in Russia, secured by contracts for the delivery of, and enforceable pledges of crops and future harvests. These contracts and pledges are enforceable and enforced in Russian courts.

International grain trading companies may prudently expand their direct lending to Russian agricultural producers of funds to finance the production of crops for export or domestic sale, taking as security an enforceable pledge of the crops financed, and registering the pledge in the Russian Register of Pledges. A grain trading company would enter into an enforceable contract for the purchase of financed crops, plus take as collateral enforceable pledges of other movable and immovable property belonging to producer, and could reasonably expect everything to go according to plan with each identifiable legal and commercial risk adequately addressed.

Certain grain trading companies and certain equipment manufacturers may have a shared desire to jointly back a particular Russian producer, producing larger business opportunities for all three parties, while, at the same time, lowering risks for each party.

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1. Introduction

The Russian agricultural sector is experiencing growth; it has been producing increasing volumes of production of a large variety of crops, including wheat, corn, barley, soy and sugar beets. Grain crops grown in Russia are in demand around the world. There is also a much higher rate of consumption of grain within Russia, allowing increased production of poultry and other livestock within Russia. Yet, there is one large commercial problem on the mind of Russian agricultural producers in mid-2015, and it is the cost of money. International grain traders can profit from helping to solve this problem.

2. The Commercial Problem

A. The Cost of Money in Russia in 2015

At the Sixth International Conference for agricultural producers and suppliers of agricultural inputs and services held on February 6, 2015 in Moscow, certain of the main speakers quite boldly complained about Russian government and bank priorities as regards Russian agriculture. In one panel discussion, a table presenting financial statistics was posted alongside a list of three questions, and a spirited discussion followed before an audience of perhaps 300 attendees, including representatives of all of Russia's main agricultural producers.

The main statistics presented were that, for short-term credits, where the average interest rate in 2014 had been 12.5%, in 2015 it was now 25%. The promised rate of Russian government subsidies for interest rates was also increased from 5.5% to 14.68%, resulting in an effective interest rate increasing from 7% to 10.32%.

For investment credits, where the average interest rate in 2014 had been 13%, in 2015 it was now 25%. The promised rate of Russian government subsidies for interest rates for investment projects was 8.25% and was being kept at 8.25%, resulting in an effective interest rate for investment projects increasing from 4.75% to 16.75%.

The questions presented for discussion were: (1) Are the financial and agriculture markets ready for these new economic realities, and what predictions can be made? (2) What can the government and the banks themselves do to soften the credit policies for the agricultural producers? (3) Should agricultural producers take or not take loans in these conditions? What choice will agricultural producers make?

In the discussion that followed, leading figures in the Russian agriculture industry from across the country openly mocked the government, showing the business community is extremely frustrated with what is perceived as the incompetence of government policy toward the agriculture sector. One industry panelist asked bankers from two major state-owned bank who were present, "Can we have a new policy like for the Olympics? We should invest huge sums into the agriculture sector and then write it off as we did for the Olympics. Couldn't we do that?"

The bank representatives replied, "No, the government has just done a wise thing committing huge sums to recapitalizing the banks." The agriculture industry representative vehemently objected, nearly falling out of his seat, "Wait, wait! It's because you are telling the government things like that that we are in these

problems! You bankers should give up your bonuses!" His retort brought about general and sustained applause in the hall. He continued. "The stores are going to be empty! The government is not looking at where its policies are taking us!"

In the ensuing discussion the agricultural producers made clear that, with such a high cost of money, their enterprises could not afford to take bank loans but would only be able to finance what crops they could using their own capital. Production would fall well below what would otherwise be achievable.

B. Impediments to Production, other than the Cost of Money

The growth of the Russian grain producing industry is presently impeded, domestically and for export purposes, by several interrelated economic, legal and political issues in addition to the cost of money in Russia. This paper does not analyze the political issues in detail, which are primarily reflected in two areas, but, to name a few:

(1) There is an export duty that has been impeding exports and causing domestic prices to collapse due to domestic oversupply because of reduced exports. Russian Government decree No 1495 of December 25, 2014 increased the customs export fee on wheat to 15% of its customs value, plus 7.5 Euros per ton, and not less than 35 Euros per ton in total that came into effect as of February 1, 2015 through June 30, 2015.

In late May 2015, the Russian Ministry of Agriculture announced proposed changes to the duty on grain exports. From July 1, 2015, the duty will be calculated in rubles, but will only apply if and when the exchange rate of a dollar exceeds 60 to 70 rubles. If the exchange rate is 60 rubles or lower, the export duty will not apply and should not affect either export or domestic prices of grain. Export contracts are denominated in dollars, and it is proposed that, if a contract price in terms of US Dollars exceeds 11,000 rubles per ton, the duty will be calculated as one-half of that price minus 5,500 rubles. If the price is less than or equal to 11,000 rubles per ton, the duty will be set at 1 ruble per ton.

(2) Government policies require some crops to be sold in local regions, also resulting in lower prices to farmers.

(3) The Russian federal government operates a program to subsidize interest rates payable by certain producers. However, this program was criticized at the IKAR conference as not being large enough to reduce the cost of financing to producers on the required scale, and also for being a subsidy that would be payable after costs have been incurred, therefore, not removing the need to pay the high cost of interest rates up front.

(4) Interest rates are unaffordably high in Russia due to several factors. As noted below, several leading Russian state-owned banks are presently subject to economic sanctions that prevent them from borrowing funds at low costs for long terms from leading global capital markets, thereby cutting these banks off from access to low cost sources of funding. Interest rates are reportedly set high by the Russian Central Bank in order to preserve the value of the ruble, at the cost of impeding investment activity within Russia. Russian banks are undercapitalized and unable to address all lending needs in the Russian agriculture sector. They finance a few high profile projects, and are unable to serve leading agricultural producers.

The consequence of the foregoing political and economic factors is that interest rates for loans to the Russian agricultural sector are prohibitively high. Russian grain producers say they cannot afford to borrow the necessary funds to plant all the hectares of crops that they could grow.

3. The Business Opportunity

The foregoing circumstances suggest there is a need for, and an opportunity for profitable extension of trade credits to Russian agricultural producers by non-bank lenders and domestic and international grain traders. The opportunity is to pre-pay against future delivered volumes of marketable grains and for traders to increase their origination platforms and volumes in Russia. International grain traders are in a position to access the much lower cost of capital and loans outside of Russia and to use such funds to prep-pay for crops grown within Russia.

Yet, presently, certain international grain traders express that they are studying the opportunity, but, to date, are impeded by a perception of high risks involved, and aspects of providing financing that are still expensive, such as the cost of using an intermediary financial institution and the cost of default insurance. A small number of Russian banks take pledges of crops as collateral for loans apparently for working capital and investment purposes having a term of from 1 to 3 years.

The purpose of this paper is:

- (1) to explain that there is a working system for international grain traders to lend funds to agricultural producers in Russia, secured by contracts for the delivery of, and enforceable pledges of crops and future harvests, and these contracts and pledges are enforceable and enforced in Russian courts, and
- (2) to demonstrate that international grain trading companies may prudently expand their direct lending to Russian agricultural producers of funds to finance the production of crops for export or domestic sale, taking as security an enforceable pledge of the crops financed, and registering the pledge in the Russian Register of Pledges, plus entering into enforceable contracts for the purchase of financed crops, plus taking as collateral enforceable pledges of other movable and immovable property belonging to producer, and reasonably expect everything to go according to plan with each identifiable legal and commercial risk adequately addressed.

4. The Legal Risks, and their Solutions

A. The Legal Mechanics of How to Create an Enforceable Pledge of a Crop

The substantive law about the creation and enforcement of a pledge is found in Article 339.1, 342 and 342.1 of the Russian Civil Code. The procedural steps to create a pledge are found in Article 103.1 of the Fundamental Law of the Russian Federation on Notaries and in an approved form for the registration of a pledge of movable property in the unified Register of Pledges maintained by the Russian Federal Chamber of Notaries.

Article 339.1 of the Civil Code provides that a pledge of property, other than immovable property for which there are additional requirements, requires the registration of a notification of the pledge collateral received by the pledgor. The register is maintained in accordance with the Law on Notaries.

The pledgee is entitled in relation to third parties to rely on its rights under a pledge only from the date of recording of a notation about the existence of the pledge in the Register of Pledges, unless a third party knew or should have known about the existence of the pledge before that. The lack of a recording of a notation about the existence of the pledge in the Register of Pledges does not affect the relationship between the pledgor and the pledgee.

Article 342 adds that if pledged property becomes the subject of another pledge to secure other claims (a subsequent pledge), the requirements of the subsequent pledgee are satisfied from the value of the property after the requirements of the prior pledge holder. A subsequent pledge is permitted, unless otherwise provided by law. If the prior pledge agreement provides terms on which a subsequent pledge agreement may be entered into, the subsequent pledge must be concluded in compliance with the specified conditions, or the prior pledge holder will have the right to demand from the pledgor reimbursement of any losses.

A pledgor must inform each subsequent pledgee about all existing pledges of property, and is responsible for losses caused as a result of failure to do so, unless it is proved that a pledgee knew or should have known about prior pledges.

B. Lessons Learned from Pledges of Crops Recorded in the Register of Pledges

In May 2015, we searched the Russian Register of Pledges to locate all filings that we could concerning pledges of future harvests of crops. We located 27 "Public Notification Data Reports" about pledges of crops that were filed since the Register of Pledges was created in July 2014 and the present date. These 27 filings were made by four categories of pledgees:

- (1) 5 commercial banks, which primarily were securing extensions of credit of 1 year or 3 years, however, also were securing short-term credits of from 4 months to 7 and 9 months;
- (2) 1 trading company that was securing short-term credits of from 10 days to 3 months and 5 months;
- (3) 1 holding company that was securing a short-term credit of 2 months; and
- (4) 1 individual who was securing a credit of an unclear term.

	Name of Pledgee	Number of Pledges	Term between date of pledge agreement and date for fulfillment of secured obligation	Type of Crop

	Banks			
1	Bank Center-Invest, Rostov-on Don	15	1 year, 3 years, 4 months, 9 months	Winter wheat; spring wheat, potato, onion
2	Russian Agriculture Bank (Rosselkhozbank)	4	4 months, 7 months, 9 months, and 1 year	Corn, winter wheat, sunflower
3	Land Commercial Bank	1	1 year	Sunflower
4	Bank Vozrozhdenie	1	1 year	Wheat
5	Sberbank of Russia	1	1 year	Wheat
	Trading Company			
1	Limited Liability Company "Trade Agro Soros Trade"	3	5 months, 10 days and 3 months	Sugar beets, winter wheat, and corn
	Holding Company			
1	Limited Liability Company "Magarach Invest"	1	2 months	Winter barley
	Individual			
	Makhrov Alexander Evgenevich	1	Not clear	Wheat

The overall number of recorded filings of pledges of future crops, 27, seems to be quite small, considering the scale of Russian agricultural production. We would be speculating to guess why there are not more filings concerning pledges of crops during the last year.

Bank loans of 1 year and 3 years would be consistent with lending to provide annual working capital, and to support some investment projects. The terms of the extensions of credit by the one trading company that made filings would be consistent with short-term trading activity and possibly short-term working capital requirements.

What becomes clear from a review of extracts from the Russian registry of pledges about pledges of crops is that, in the year since the Register of Pledges was created in July 2014:

- (i) none of the world's top grain trading houses appear to be lending funds to Russian agricultural producers for working capital and investment purposes that are secured by pledges of crops,
- (ii) none of the world's top grain trading houses appear to be lending funds to Russian agricultural producers for terms long enough to finance the planting and harvesting of crops, secured by a pledge of crops,

- (iii) no non-Russian banks appear to be engaged in any lending secured by pledges of crops,
- (iv) 2 of the 5 Russian banks that did lend funds to Russian agricultural producers are now subject to international sanctions, Sberbank and Russian Agriculture Bank (Rosselkhozbank), which limits their ability to access low cost global capital markets to support agricultural producers in Russia, and
- (v) several non-bank lenders are lending funds to Russian agricultural producers secured by crops, showing it is possible to bypass the Russian banking system, particularly sanctioned banks, and to lend funds directly to Russian producers secured by future crops.

The world's top grain trading houses and non-Russian banks could lend funds to Russian agricultural producers for terms of 1 year or more as certain Russian banks are doing. Extensions of credit to Russian agricultural producers could be secured by pledges of crops and mortgages of owned or leased land plots, contracts to purchase financed crops, and pledges of rights to payment for the sale of crops to Russian or international grain traders or other purchasers.

The purpose of this article is to show that pledges of crops and proceeds from the sale of crops can be a reliable form of security for extensions of credit to Russian agricultural producers. Further, financing provided to a Russian agricultural producer by a grain trading company may be coupled with loan and lease financing from equipment manufacturers to support production by selected Russian agricultural producers (and Kazakh and Ukrainian producers under their national laws).

C. Lessons Learned from a Review of Russian Court Cases Concerning Pledges of Crops

There have been a number of litigations in Russia involving a variety of issues concerning pledges of crops prior to their harvesting. Below, we have summarized six recent Russian appeals court opinions to provide a sampling of issues that give rise to litigation. These cases show that pledges of future crops and guarantees, if properly formulated, are enforceable, and the system works.

Measures must be taken to provide in a pledge agreement for the physical handling and protection of a pledged crop to assure it is not physically stolen. A creditor must be diligent in enforcing its rights, and show up in court to defend its rights.

Insurance of a crop is commonly used in Russia as an additional source of funds to repay bank loans if a crop is damaged while it is being grown. An insurance claim may be in an amount less than the limits of the insured amount set out in an insurance policy, depending on the facts and circumstances.

1. Rosselkhozbank v. Agro Kozlovka

In the case of *Rosselkhozbank v. Agro Kozlovka*, a decision of Supreme Court of Republic of Mordovia, dated 2 April 2015, Rosselkhozbank had sued Agro Kozlovka and an individual entrepreneur, the head of a farming enterprise for property pledged as collateral for a loan agreement and a loan made in December 2009 that was to be repaid in November 2010. In addition to the pledge, there was a personal guarantee, a pledge of vehicles, a pledge of a future harvest, a pledge of farm animals, and a pledge of working capital.

A third party complaint was made to declare the personal guarantee invalid for not having been approved by the guarantor's spouse.

The complaint by Rosselkhozbank was partially satisfied and a length list of property was seized, including automobiles, seeding machines, a quantity of winter wheat, young cattle, a quantity of barley grain, a garage, parts of two buildings, a land plot, a number of purebred pigs and boars, plus amounts due under a guarantee giving rise to joint personal liability.

Lessons learned: Pledges and guarantees, if properly formulated, are enforceable. The system works.

2. L.A. vs Mayak

In the case of L.A. vs Mayak, a decision of the Krasnodarsky Regional Court of 17 December 2014, the court refused to grant an appeal by the General Director of Mayak against a decision by a lower court, dated 28 July 2014.

L.A. sued to recover a debt owed by Mayak. A review of the case reveals no substantive or procedural error that would give justify a reversal on appeal.

The facts were L.A. had lent money to Mayak and, as collateral, Mayak had pledged its entire winter wheat harvest that would be grown on particular parcels of land, and also ownership of other particular parcels of land owned by Mayak, and also a pledge of shares in ZAO Mayak. L.A. was entitled to seize, in its discretion, any of the items of property pledged to it in the event of a default by Mayak, using either the market values of pledged property or proceeds from the sale of pledged property to a third party.

Mayak then defaulted. Article 329 of the Civil Code governs security for repayment of debts. Article 307 establishes the right of a creditor to demand of a debtor fulfillment of its obligations.

The lower court upheld the right of L.A. to seize the collateral. Since no substantive or procedural error was made, no appeal of the decision is granted.

Lessons learned: Pledges and guarantees, if properly formulated, are enforceable. The system works.

3. ZAO Vorontsovskoe vs. OAO Rosselkhozbank and OJSC Company Agroproduct

In ZAO Vorontsovskoe vs. OAO Rosselkhozbank and OJSC Company Agroproduct, a decision of Federal Arbitration Court of North Caucasus Region of 6 September 2013, ZAO Vorontsovskoe sued OAO Rosselkhozbank and OJSC Company Agroproduct to have a pledge of a future harvest, dated 28 November 2008, declared to be invalid. Agroproduct countersued that the pledge of a future crop should be replaced with a pledge of other property having a value of 45 million rubles.

An agreement of pledge of a future crop dated 28 November 2008 was entered into by ZAO Vorontsovskoe as security for a loan from LLC Alexa, a bank, for a line of credit and a loan of 57 million rubles. The pledge was of a future crop, defined as the next harvest of winter wheat and barley planted on a defined field in a planned amount, having a value of 45 million rubles.

As a guarantee of preservation of the subject of the pledge, the agreement provided for its transfer for storage in conditions and at a location agreed with the pledge holder., and also that the pledged crop could only be sold with the written consent of the pledge holder. In the event of the loss of the pledged property, an exchange for other property could occur only with the consent of the pledge holder.

ZAO Vorontsovskoe defaulted under the bank loan. The bank sued to recover the debt from LLC Alexa and two guarantors, including the pledgor, ZAO Vorontsovskoe and two individual guarantors. The court provided preliminary relief by arresting the harvest of the pledgor, but then the arrest was lifted when the plaintiff did not appear in court. The pledged crop then was lost, although the circumstances are not explained.

The court ordered ZAO Vorontsovskoe to pledge other property to Agroproduct of equal value, 45 million rubles. According to Article 345 of the Civil Code, a change in the subject of a pledge is permitted with the approval of the pledge holder. If the subject of a pledge is lost, the pledge holder may require a change to a pledge agreement in court pursuant to Article 450 of the Civil Code.

Lessons learned: Measures must be taken to provide in a pledge agreement for the physical handling of a pledged crop to assure it is not physically stolen, and a creditor must be diligent in enforcing its rights and show up in court to defend its rights.

4. LLC Rassvet vs. Insurance Group Uralsib

In LLC Rassvet vs. Insurance Group Uralsib, a decision of the Arbitration Court of the Povolsk Region dated 26 March 2015, LLC Rassvet had sued in the Arbitration Court in Samara against Insurance Group Uralsib for 3.4 million rubles of insurance to be paid to Rosselkhozbank.

Rassvet purchased insurance from Uralsib for a crop, naming Rosselkhozbank as a beneficiary. Rosselkhozbank had lent 4 million rubles to LLC Rassvet and taken a pledge of the crop. An insured event occurred, a damaging storm, leading to a smaller harvest than planned. Uralsib did not pay the claim. Payment of insurance to a third party is allowed by Articles 930 and 430 of the Civil Code.

Lesson learned: Insurance of a crop is commonly used in Russia as an additional source of funds to repay bank loans if a crop is damaged while it is being grown.

5. LLC Svetlogorskoye Grain vs. Alfa Insurance

In LLC Svetlogorskoye Grain vs. Alfa Insurance, a decision of the Arbitration Court of the Urals Region, dated 25 March 2015, Rosselkhozbank was involved as a third party, and asked for lower court decisions to be overturned. The lower court had used a formula for the amount of an expected harvest of 4.29 kg / ha when the insured harvest was of 9.1 kg / ha. [Yields for crops in open ground are calculated quintals per hectare.]

The insurance policy was crop insurance for sunflower seeds. The insured value of the crop was 109.2 million rubles. The amount of insurance was 59.6 million rubles. There was a deductible of 5%. The acreage was 12,000 hectares. The average yield was to be 9.1 kg / ha, with a price in rubles. The level of insurance coverage was 55%. The completion date of sowing was 25.05.2012. The date of completion of

the harvest was 30.10.2012. The pledged property was also the subject of a pledge of a future crop made with Rosselkhozbank.

In accordance with Paragraph 2.4 of the insurance policy, an insured event included the loss or partial loss of agricultural products, including the harvest, the harvest of perennial plantings as a result of exposure hazardous chemicals, or a number of natural phenomena, including drought, frost, freezing, hail, dust, sandstorms, earthquakes, flooding, or excessive moisture; and also a harvest less than the five-year average yield in the current year as a result of an insured event. There was a defined procedure for determining average yield, and for calculating the amount of insurance in the event of loss.

During the period of insurance, a drought occurred. The insured party contacted the insurer, which made out a report about an insured event, dated 12.04.2013. According to the Act, Alfa Insurance admitted the existence of an insured event, and an amount of insurance due of 25.3 million rubles, which was paid by the defendant. Svetlogorskoye Grain sued because the amount of insurance paid was less than the insured amount.

According to Article 929 of the Civil Code, an insurance payment is due within the limits of the insured amount set out in an insurance policy. Alfa Insurance obtained an expert opinion that:

1. On 3939 hectares (32% of the total crop) a harvest of sunflower had not grown; the remaining area was marked by thin stalks and low productivity of the plants.
2. According to a State Organization, on the territory during the insurance period, there was one dangerous drought resulting in "dry soil", fully meeting the criteria specified in the insurance policy.
3. The biological productivity of sunflower within the norms for losses in harvesting and processing on 8,111 hectares was 2.0 t / ha.
4. The actual yield of sunflower seeds in 2012 on 12,000 hectares of crops should have been 1.3 kg / ha. There was a loss of 7.8 t / ha of sunflowers.
5. The reasons for the lower yields of sunflowers were a violation of agricultural technology - the presence of weeds in the crops resulted loss of crops in the amount of 0.8 kg / ha; the "drought" and other adverse weather conditions, which resulted in not satisfying the criteria specified in the insurance policy, which led to the loss of crops at the rate of 7.0 kg / ha.

The average harvest was determined mathematically over 5 years preceding the insured year, including years when the crop was lost entirely. The insurance policy stipulated a yield of sunflowers of 9.1 tons / ha. The court found that the average yield from 2007 to 2011 was 6.39 t / ha, which is 2.71 t / ha less than stated by the insurer.

Given the expert opinion, the conclusions of which are not contested, the courts have come to the reasonable conclusion that the actual shortfall with the overstatement of productivity adopted by insurance amounted to 4.29 t / ha. On the basis of an expert opinion and documents received from Rosstat, "Alfa Insurance" calculated the amount of insurance compensation in accordance with the p. 5.2 of the contract from 26.03.2012 to be 25.3 million rubles.

Having examined the evidence in the case file, including the contract for crop insurance, the rules for crop insurance, and evidence about agro-meteorological conditions, the courts rightly concluded that there was

insufficient proof that "Alfa Insurance" had not fulfilled its obligation to "Svetlogorsk grain" under the insurance contract of 26.03. 2012, and rightly rejected the plaintiff's claim to recover unpaid insurance from "Alfa Insurance". The appeal court would not engage in a reassessment of evidence that had been the subject of study and evaluation of the court of first instance and court of appeal. The reassessment of evidence is not within the competence of the court of cassation. The applicant's argument that it had grounds to recover funds for the benefit "Rosselkhozbank" were correctly rejected by the courts because "Rosselkhozbank" was not a beneficiary under the insurance contract and had made no claims itself.

Lessons learned: An insurance claim may be in an amount less than the limits of the insured amount set out in an insurance policy, depending on the facts and circumstances.

6. Agrotorg vs. Sakho Agro Ulyanovsk

In the case of Trade House Agrotorg vs. ZAO Krasnosibirskoye, a decision of the Federal Arbitration Court of the Western Siberian Region of 21 May 2014, Trade House Agrotorg appealed against a decision of the Arbitration Court of the Novosibirsk Region and the Seventh Arbitration Appeals Court concerning the bankruptcy of ZAO Krasnosibirskoye and demanded repayment of 1.5 million rubles.

Agrotorg appealed against the lower court decision that it was not a secured creditor. Agrotorg argued the bankruptcy administrator of ZAO Krasnosibirskoye had not delivered to the court evidence which had been requested, which was in the possession of the debtor, about a pledge of a future crop.

The appeals court denied the appeal. Agrotorg had entered into a large number of related agreements under which a number of agricultural enterprises, including ZAO Krasnosibirskoye, had agreed to joint liability for a loan. There were nine other legal entities that also acted as guarantors. The courts held that a guarantee was not a pledge and ZAO Krasnosibirskoye had not, in fact, pledged anything. And, Agrotorg's argument that the burden of proof ought to be reversed, and ZAO Krasnosibirskoye should be required to disprove the existence of a pledge was denied.

Lessons learned: A guarantee should not be mistaken for a pledge.

D. Lessons Learned from International Best Practices

(1) Lessons from the Trading of Wood Products

An international grain trader that is considering helping a Russian agricultural producer to finance the production of crops for export or domestic sale will likely have substantial bargaining power with that producer. The parties would likely enter into a number of agreements as part of such a relationship. Drawing from our experience with one situation where an international trader was financing the production in Russia, not of grain but of certain wood products for export, the likely agreements may include:

(a) a loan agreement directly with the Russian legal entity that is the agricultural producer; this may be either a cross order loan, or a domestic loan made within Russia if the trader prefers, possibly with provision that the credit is to be repaid out of proceeds from the purchase and re-sale of product;

- (b) a loan agreement with the parent company of the Russian legal entity that is the agricultural producer, or with its affiliated trading company within Russia or outside of Russia;
- (c) a short-term or long-term contract for the purchase of the entire crop to be grown on certain specifically designated fields, possibly providing that the credit shall be provided as an advance payment for the purchase of the crop rather than pursuant to a separate loan agreement;
- (d) a pledge agreement pledging to the grain trader the entire crop to be grown on certain specifically designated fields while the crop is growing, or after it is harvested and stored in separably identifiable facilities;
- (e) a pledge agreement pledging to the grain trader other specifically identified movable and immovable property, and also a floating pledge of all other property belonging to producer;
- (f) an agency agreement pursuant to which the grain trader shall act as the marketing department of the producer and purchase its entire production for resale, or an agreed quantity, and possibly also undertake obligations to direct proceeds from sales to paying down certain bank loans unrelated to funds provided by the trader;
- (g) a management agreement whereby the trader will be involved in day-to-day activities at the producer and be able to oversee the production, harvesting, handling, storage and movement of the crop, with a view to preventing the crop being physically lost or claimed by another creditor;
- (h) one or more corporate guarantees from legal entities in the producer's corporate structure, within Russia, and outside of Russia; and possibly
- (i) one or more personal guarantees from controlling shareholders, with care taken to obtain spousal consents to all personal guarantees

Depending on the scope of the relationship between the trader and the producer, the primary contractual agreement between them may be a purchase agreement to purchase product, with a pledge agreement as a secondary tool.

(2) Lessons Learned from the Absence of Rules like the Grain Trade Rules

One adage about the practice of law in Russia is that where the law is thick, the contract may be thin; and where the law is thin, the contract must be thick. International grain traders are, naturally, be very sophisticated in their expectations about the products in which they are dealing and prevailing business practices. However, one mistake for foreign companies new to Russia is to make an assumption that there is a shared set of rules of the road, a shared level of sophistication and expectations in Russia as, for example, in the US. It is a necessary exercise to study established rules for trading practices "at home" wherever that may be, and, rather than take anything for granted specifically include the rules one requires in a contract for use in Russia if those rules are not set out here in a generally applicable set of rules.

For example, in the U.S. detailed rules were adopted in 1902 by the National Grain and Feed Association (NGFA) that govern all transactions of a financial, mercantile or commercial nature involving grain (the NGFA Trade Rules). See <http://www.ngfa.org/trade-rules-arbitration/rules/> Grain, as defined by the U.S. Grain Standards Act, means corn, wheat, rye, oats, barley, flaxseed, grain sorghum, soybeans, mixed grain and any other food grains, feed grains and oilseeds for which standards are established under 7 U.S.C. Section 76. There are no rules like the NGFA Trade Rules in Russia.

The list of rules identifies many broad areas of concern that must be addressed in any grain trading contract and pledge agreement in Russia. The rules define, in Rule 1, the detailed specifications for a contract for the sale and purchase of grain. The rules go on to provide rules for brokers, confirmation of contracts, alteration of contracts, passing of title as well as risk of loss, net bushels, sample grain, unpriced contracts, inspections, rail shipments, weights, rail loading weight requirements, billing instructions, time of shipment or delivery, routing of rail grain, bills of lading, drafts, overfill and underfill grain, grain in transit or in store, loss and damage claims, failure to perform, and arbitration, including possibly at a specialized arbitration venue for grain trading issues, operated by the NGFA. Part of the thought process for a transaction in Russia would be to identify all the unspoken assumptions that a Western party may have, and then write them down in to the deal documents, and not take anything for granted.

5. How Grain Traders and Agricultural Equipment Manufacturers May Cooperate

Grain trading companies and agricultural equipment manufacturing companies may have a shared interest in backing particular agricultural producers in Russia (Kazakhstan and Ukraine). Both types of companies have the same issue with some of the same Russian (Kazakh and Ukrainian) agricultural producers which are unable to acquire all the equipment they would require to produce all the product they could produce due to the cost of financing, and legal risks in extending credit. Agricultural equipment manufacturers are generally reporting in 2015 that sales are down in Russia (Kazakhstan and Ukraine) by a large percentage as compared to 2104 due to the cost and unavailability of financing in 2015.

Since certain grain trading companies and certain equipment manufacturers have shared concerns, and a shared need to bypass the dysfunctional Russian banking system if possible, it would seem a next logical step for them to collaborate to back a particular Russian producer, while, at the same time, lowering both of their risks. The credit risk for an equipment manufacturer in selling or leasing equipment to a customer may look more reasonable if it were looking to get paid the balance it may be owed by a producer out of proceeds from the sale of crops - not solely directly from its customer, but from a grain trading company that purchases the customer's crops that are pledged to it. This could be workable, as a legal matter.

A transaction that is under discussion by certain grain trading companies and certain equipment manufacturers to back a particular producer may include the following elements:

- the equipment manufacturer and the grain trading company would identify a Russian (Ukrainian or Kazakh) producer needing more equipment and more financing to increase production in order to have more grain products to sell to the grain trading company,
- that producer would assign to the equipment manufacturer proceeds from the sale of its crops to the grain trading company,

- that producer would authorize the grain trading company to pay proceeds from the sale of crops directly to the equipment manufacturer,
- the grain trading company would advance funds to that producer to finance the planting and fertilizing of additional crops, including the use of funds to purchase or lease equipment from the equipment manufacturer,
- the equipment manufacturer would provide loan or lease financing to that producer,
- the grain trading company would have a pledge of the additional crops and a contract to purchase and re-sell those additional crops,
- the equipment manufacturer would also retain a pledge of, or ownership of leased equipment until the equipment manufacturer is paid in full.
- an issue for discussion would be the extent to which the equipment manufacturer and the grain trading company would share the financial risks and the relevant forms of security.
- the equipment manufacturer typically would not get involved with the sale of crops, so would not likely be looking to benefit from a pledge of crops, but to leave that to the grain trading company which would then pay you out of proceeds.
- the agreements would make clear that the grain trading company would only have an obligation to pay the equipment manufacturer, and would only pay the equipment manufacturer out of proceeds from the successful acquisition and sale of crops.
- the equipment manufacturer would still be better off for having funds coming to it from this, possibly in hard currency outside of Russia (Kazakhstan and Ukraine), rather than having to wait for funds to be received by the producer and then paid to it, with those funds being subject to the legal risk of being seized by other creditors of the producer before payment to the equipment manufacturer.