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THE ROLE OF MEZZANINE CAPITAL IN FINANCING ENTREPRENEURIAL ACTIVITY AND ITS LEGAL REGULATION

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Abstract. This article aims to examine the role of mezzanine financing – a non-traditional, hybrid instrument – in situations where conventional methods (bank loans, leasing) lack flexibility and sufficient risk appetite for innovative projects. Mezzanine finance combines elements of debt and equity, allowing companies to attract substantial capital without diluting existing shareholding, and holds an intermediate position in the priority ranking during insolvency, situated between senior creditors and shareholders. The core of the research consists of a comparative analysis of mezzanine's legal regulation. The article details the relationships between the key participants in a Mezzanine transaction – the borrower, the senior creditor, and the mezzanine creditor – including their priority, the collateral (shares/equity interests), and return requirements. The conclusion substantiates the need to implement relevant norms into Uzbekistan's national legislation, drawing on the similarities between mezzanine and existing financing types, including the introduction of accelerated foreclosure procedures and the establishment of legal certainty for private investments.

Keywords: hybrid capital, mezzanine financing, legal regulation, entrepreneurship, investor, structural subordination, share

Introduction

The development of entrepreneurial activity is primarily determined by the availability of adequate financing sources. Financing is the process of attracting monetary funds necessary for entities to start, expand, and modernize their operations. Traditional financing methods, particularly bank loans and equity issuance (capital financing), have long served as the main pillars of economic development. However, each method has its distinct drawbacks: bank loans are constrained by high interest rates and rigid collateral requirements. Equity financing (such as IPOs) demands complex legal procedures and high costs.

Current trends in the global financial market, driven particularly by the needs of small and medium-sized enterprises (SMEs),

indicate a growing demand for new financing instruments that combine the advantages of both debt and equity. Hybrid financing serves as such an alternative solution, distinguishing itself significantly from other types due to its flexibility. Its key characteristic lies in the ability of debt instruments (e.g., bonds) to acquire the features of equity instruments (shares). Specifically, the investor initially acts as a creditor, receiving a fixed interest income. However, in the future, depending on the company's growth, they acquire the right to convert this debt into equity. This mechanism allows companies to mitigate financial risks and increase investment attractiveness.

The significance of hybrid financing is growing globally year by year. While startups in the US actively raise venture capital through convertible loans, large corporations in developed markets like the European Union and Japan are expanding their capital base using convertible bonds. Practice in these countries' financial markets demonstrates that hybrid instruments not only offer convenience for companies but also provide investors with the potential for higher returns and lower risks.

These trends necessitate the study of hybrid financing mechanisms, their introduction into national legislation, and the implementation of necessary measures to protect the rights of both parties during the legal regulation process.

However, within the national legal system, the civil-law nature of hybrid financial instruments – specifically mezzanine financing – has not yet been systematically researched. The primary legal challenge is that mezzanine transactions occupy the intersection of the law of obligations and property law, and their status is not clearly defined in current legislation. This, in turn, creates significant legal conflicts regarding the priority of creditor claims in the event of the debtor company's insolvency. The legal relevance of this article is underscored by the fact that the rigid hierarchy of creditor priority in the Civil Code of Uzbekistan and the absence of the institute of contractual subordination (priority agreements) negatively impact the investment climate. The objective of this research is to classify mezzanine financing as a distinct institute of civil law and to provide a scientific justification for its legal consequences within bankruptcy proceedings.

Methods

This article, as a research study, encompasses an analysis of various sources. Scientific concepts, the views and conclusions of practicing scholars, and expert opinions concerning the field have been examined in this paper. Furthermore, the regulation of mezzanine financing in different jurisdictions has been analyzed from a comparative legal perspective.

The foundation of the research methodology consists of comparative-legal and systematic analysis methods. The object of the study is defined as the property relations that arise between the investor, the debtor, and other creditors during the mezzanine financing process. The subject of the research pertains to the norms of foreign jurisdictions and national legislation that regulate these specific relations.

The experiences of the United States, the United Kingdom, and Germany were selected for the comparative analysis. Specifically, the United States possesses the most extensive case law regarding the integration of mezzanine instruments with capital markets and lender liability. The United Kingdom has developed the internationally recognized LMA (Loan Market Association) standards, based on the principle of freedom of contract inherent in English law. Germany, representing the Continental legal system, offers a model for regulating mezzanine financing through the "Silent Partnership" (Stille Gesellschaft), providing relevant experience for aligning such instruments with the legal system of Uzbekistan.

The article begins by exploring the core concepts related to the topic, followed by an exposition of the procedure for financing entrepreneurial activities through

mezzanine, the rights and obligations of the parties, and the procedure for concluding the relevant contracts. The advantages of this method and its legal regulatory mechanisms are compared.

Additionally, the study provides conclusions on the necessity of widespread practical implementation of this new financing mechanism and the improvement of legislative acts. The realization of these conclusions will serve to achieve several goals, including the creation of robust financial and legal solutions for entrepreneurs in carrying out their activities, the formation of a unique competitive environment among financial institutions and investors and the guaranteeing of investor rights and the establishment of a climate of trust between them and entrepreneurs.

Results

Traditional methods of financing entrepreneurial activities, such as bank credit, leasing, and factoring, continue to play a crucial role in business development. Their main advantages lie in their stability, clear rules, and widespread use. However, in today's rapidly changing, digitized, and innovation-driven environment, their drawbacks in terms of flexibility and speed are becoming apparent.

Traditional financial institutions often shy away from high-risk projects. The global market demands fast and flexible methods of entrepreneurial financing to strengthen the guarantee of rights for both the entrepreneur and the investor.

It is precisely due to these shortcomings that non-traditional financing methods, particularly hybrid mechanisms, are becoming increasingly important today. These can accurately be described as securities that combine elements of both debt obligations and equity participation instruments. They are an attractive tool for companies seeking financing without increasing nominal debt or diluting the equity share of existing shareholders.

Among the most widespread types of hybrid financing in developed countries is mezzanine financing. The concept of mezzanine financing is one of the most advanced and flexible approaches, widely used by companies across developed financial markets worldwide.

Mezzanine is a type of financing that possesses the characteristics of both debt and direct investment. Under this structure, the investor typically does not enter the company's equity but instead provides funds for its development through debt obligations while simultaneously acquiring the right to purchase the borrower's shares at a predetermined price in the future (Pirkova, 2017).

Mezzanine financing first appeared in the USA in the 1980s. In contrast, the first mezzanine financing fund in Russia was established in 2009 under the name Volga River Credit Opportunity (Mokina & Strelnikov, 2017).

The mezzanine market in the USA is quite developed and standardized, with mostly private equity firms operating within it. In the European market, however, mezzanine financing is more often implemented by commercial banks.

The positive aspects of this financing method are that mezzanine creditors demand less collateral than banks, as they intend to cover the risk from the company's future earnings. Furthermore, it allows the company to raise a large amount of capital without selling a substantial share of its equity (Strelnikov, 2017).

Another distinctive feature of mezzanine financing is that, in the event of corporate insolvency (bankruptcy), the repayment of mezzanine debt is considered an intermediate priority. That is to say, the security for the obligations is directed first toward the claims of bank loans (senior debt), secondly toward mezzanine debt, and only then toward the shareholders' claims (Chernikov, 2024).

According to Professor James Fawcett, the main legal challenge in these transactions is the "hierarchy of creditors" (or "creditor hierarchy"). The

mezzanine creditor typically holds a lower level of protection compared to senior creditors (such as banks). Consequently, all procedures concerning payments and the rights in cases of potential insolvency must be clearly stipulated in the legal documentation (Fawcett, 2010).

Mezzanine financing initially emerged in market practice and subsequently found its reflection in the legislation of most developed countries (USA, Great Britain, and Germany). In the USA, mezzanine transactions are regulated by the Uniform Commercial Code (UCC) (USA, n.d.) and the Securities Act of 1933 (USA, 1933). In the European Union member states, there are generally no specific statutes dedicated solely to mezzanine financing. Its legal aspects are primarily regulated within the framework of civil codes, commercial legislation, and the rules governing the activities of investment funds.

In the Russian Federation, according to the Civil Code, mezzanine financing is formalized by signing a loan agreement first, followed by an option agreement. The option agreement stipulates the procedure by which the investor obtains shares or equity stakes belonging to the subject (Chernikov, 2024).

The process of formalizing financing resembles the formalization of other types of investment. Specifically, an enterprise requiring funds first submits an application to a mezzanine fund. The fund conducts an in-depth analysis of the company's financial condition, business model, and growth prospects. The fund and the company agree on the financing terms, including the interest rate, repayment period, and the conditions for conversion into equity. After the agreement is reached, the fund transfers the capital to the company. The company makes interest payments over the agreed period and repays the principal at the stipulated maturity date. If the company is sold or issues an IPO, the fund profits by selling its stake (Sazonov, 2016).

According to Corry Silbernagel & Davis Vaitkunas (K. Silbernagel & D. Vaytkunas), mezzanine financing can primarily take the form of subordinated debt convertible into equity or redeemable preferred shares. Mezzanine in the form of preferred shares is, in essence, an equity investment, but it maintains priority regarding dividend payments (Silbernagel & Vaitkunas, 2012).

Mezzanine financing is a new form of funding that interlinks the characteristics of debt and equity. It classifies mezzanine through various instruments (subordinated loans, preferred shares, etc.), which implies its subordination to different laws in terms of legal regulation.

L. Tetřevová and J. Svědík divide mezzanine financing into two main types: private mezzanine (Subordinated loans, syndicated loans, "silent" participation) and public mezzanine (Tetrevova & Svedik, 2018).

Subordinated loans are unsecured debts. This type of debt has a lower priority compared to senior debt in case of bankruptcy.

Syndicated loans are large-volume debts provided to a borrower by a group of two or more creditors (a syndicate), participating in pre-agreed shares. In general, syndicated lending is standard lending but does not grant control over the property.

"Silent" participation is a financing method where the investor (informally known as a "silent partner") participates in another person's business through a pledge of capital and, in return, acquires the right to participate in the company's profits but does not assume any obligations to the company's creditors.

Leach and Melicher (Leach & Melicher, 2014) also classify convertible bonds, option bonds, and preferred shares as public mezzanine instruments.

Currently, mezzanine financing is utilized in practice in the following forms (Lurie & Melikhov, 2013):

1) Mezzanine Debt. This typically takes an unsecured form in the USA and a subordinated form in Western Europe. Subordination implies that the creditor is

granted the right to subsequent retention or pledge of the property, meaning the interests of the senior creditor are prioritized. There is also "structural subordination," where senior creditors conclude debt agreements secured by the assets themselves (i.e., the assets are put up as collateral). Concurrently, the mezzanine creditor provides the loan secured by the shares of the companies that hold the underlying assets.

2) Financing with "Undisclosed" Investor Participation. In this structure, the investor acquires shares in the borrower company but does not assume any liability to the company's creditors.

3) Financing Secured by the Issuance of Convertible Bonds. These bonds stipulate fixed interest payments and the repayment of the principal debt at the end of the financing term. At the same time, the instrument allows the investor to purchase shares of the borrower company at a predetermined conversion price instead of the return of the principal debt.

4) Financing Secured by the Issuance of Preferred Shares. This involves the issuance of the borrower company's preferred shares. Such shares grant preferential rights to participate in profits and the liquidation value compared to the holders of the company's other shares.

In our view, the legal nature of a mezzanine transaction is that of a "mixed contract," which simultaneously integrates various institutes of the law of obligations. Specifically, this legal construct comprises the following elements:

Principal Debt Obligation (Loan): Debt relations in accordance with Article 732 of the Civil Code of the Republic of Uzbekistan.

Contractual Subordination: A specialized agreement (Intercreditor Agreement) that establishes the hierarchical priority for satisfying creditor claims.

Conversion Rights: An option or warrant allowing the creditor to convert debt into shares or equity interest in the future – a proprietary right (Article 81 of the Civil Code).

Thus, mezzanine financing is a sui generis type of obligation that combines elements of debt and corporate law, positioning the creditor's legal status higher than a general creditor but lower than a shareholder.

In managing legal risks within mezzanine relations, the judicial practice of developed nations plays a pivotal role. This study identifies two critical doctrines regarding the legal status of mezzanine creditors:

The Doctrine of "Equitable Subordination" (US Experience): Developed by US Federal Courts (e.g., Benjamin v. Diamond / In re Mobile Steel Co.) (Benjamin, 1977), this doctrine dictates that if a mezzanine investor unjustifiably interferes in the company's management, resulting in harm to the interests of other creditors, the court may relegate their claims to the lowest priority. For Uzbekistan, this implies that legislation must clearly define the boundaries of investor interference and their tort liability (liability arising from causing harm).

Priority and Security Issues (UK Experience): Judicial precedents such as In re Spectrum Plus Ltd (National Westminster Bank plc v. Spectrum Plus Ltd, 2005) have clarified the nature of the "floating charge" and its position in the creditor hierarchy. Mezzanine creditors often hold second-tier security rights, and their protection is contractually reinforced through Intercreditor Agreements (ICA).

Furthermore, within the Continental legal system of Germany, it has been established that the rights of mezzanine investors are protected by the doctrine of "fiduciary duties." Under this framework, company directors are held accountable not only to shareholders but also to mezzanine creditors in the event of default.

Discussion

The structure of mezzanine financing involves three primary parties:

The borrower/issuer: The company receiving the financing.

The Senior lender: The most secure creditor, who holds the highest priority in the financing structure.

The Mezzanine lender: The subordinated (secondary) creditor.

The Senior lender is typically represented by large commercial banks, insurance companies, or financial institutions. In the event the company is liquidated or defaults, the proceeds from the sale of assets are first fully repaid to the Senior Lender. A loan agreement is executed between the Senior Lender and the Borrower company, and the company's primary assets (real estate, equipment, and inventory) are provided as collateral.

The Mezzanine lender is the party that ranks after the Senior Lender in terms of repayment priority, meaning they are a subordinated creditor. The main reason for this designation is that when a debtor company goes bankrupt, the mezzanine creditor only receives their share after the claims of the Senior Lender have been fully satisfied. However, they maintain priority over the company's shareholders.

This type of creditor is typically represented by private equity firms, specialized mezzanine funds, or investment banks.

Upon signing the loan agreement between the creditor and the debtor company, this contract is secured by the company's shares or equity stakes; in other words, if the debts are not repaid, the mezzanine lender gains control over the shares.

The legal relationship between the two creditors is precisely defined in a legal document known as the Intercreditor Agreement. This agreement stipulates that the Mezzanine Lender receives payment after the Senior Lender. It also defines how the Mezzanine Lender's right to gain control in the event of default is subordinated to the rights of the Senior Lender.

Mezzanine Lenders are usually not simple financial institutions like the Senior Lender (bank) but are specialized investment funds. Mezzanine Lenders obtain their funds from private equity firms or specialized mezzanine funds. These funds, in turn, manage capital contributed by investors (such as pension funds, insurance companies, large corporations, or very wealthy individuals). Therefore, the Mezzanine Lender manages the money of their own investors. These funds are prepared for higher risk (as they are second in line) but, in return, demand a higher yield (ranging from 12% to 20%) and an equity stake (Silbernagel & Vaitkunas, 2010).

Different jurisdictions have established various norms for the regulation of mezzanine financing. Specifically, in the United Kingdom, Mezzanine financing is primarily governed by common law and the following statutes:

Table 1

Legislative Acts Regulating Mezzanine Financing in the United Kingdom

Main Statute/ Rule	Relevance to Mezzanine Financing
Insolvency Act 1986 (United Kingdom, 1986)	In the event of company bankruptcy, this Act determines the priority order of creditors, particularly the Mezzanine Lender, and the process for foreclosure on collateral. The Mezzanine Lender's secondary position after the senior lender is protected within the framework of this Act.
Common Law Rules	Regulate the validity of the mezzanine agreement (loan contract), Covenants (obligations), and Default clauses. They confirm that rights in the UK are determined based on explicit contractual provisions, rather than "ownership" or "control."
Companies Act 2006 (United Kingdom, 2006)	Defines the rules governing the Equity Kicker (the right to convert to equity) and the Directors' Duties.
Land Registration Act 2002 (United Kingdom, 2002)	If the Mezzanine transaction indirectly involves real estate in certain cases, this Act dictates the procedure for the registration of real estate collateral.
Financial Services and Markets Act 2000 (FSMA 2000) (United Kingdom, 2000)	May partially regulate specific financial operations related to the equity component of mezzanine financing and investor protection requirements.

One of the most significant legal risks in mezzanine financing in the USA is the "Doctrine of Equitable Subordination," stipulated in Section 510 of the US Bankruptcy Code (US Bankruptcy Code, 2011). The purpose of this doctrine is to prevent creditors from abusing their status during insolvency proceedings to gain an unfair advantage at the expense of other creditors.

When mezzanine investors acquire control over the company (e.g., through an Equity Kicker) or deeply intervene in its management, they risk being reclassified as an "insider" and may be subjected to this doctrine.

This section of the Code grants broad powers to the court. Pursuant to it, even if a claim initially holds a high priority, the court may relegate it to a lower priority. As a result, the Mezzanine Lender's claim might fall even below the claims of other unsecured creditors.

To invoke the "Equitable Subordination" doctrine, US federal courts must prove three mandatory conditions (or requirements) during the examination of the case. These are the requirements that Mezzanine Lenders must observe with the utmost scrutiny in their activities:

Table 2

The Three Mandatory Requirements Considered by US Federal Courts when Reviewing a Case (for Equitable Subordination)

Requirement	Title	Content
1st Requirement	Inequitable Conduct	Some form of inequitable, fraudulent, or harmful conduct must have been committed by the claimant (Mezzanine Investor). This could involve, for instance, managing the company solely for their own benefit or intentionally concealing financial information.
2nd Requirement	Injury or Unfair Advantage	The inequitable conduct must have either caused concrete harm to other creditors or granted the claimant (Mezzanine Investor) an unfair advantage.
3rd Requirement	Consistency with the Code	The subordination of the claim must not be inconsistent with the other provisions of the Bankruptcy Code. (This requirement is usually fulfilled automatically in most cases).

The risk of mezzanine funds being subjected to the "Equitable Subordination" doctrine sharply increases, especially when they begin to intervene in the operational management of the borrower company. If the Mezzanine Lender acts not as a simple creditor, but as a manager, the court may find them to be an "insider" and deem the company's pre-bankruptcy transactions to have been conducted solely for the mezzanine lender's benefit. This is assessed as an inequitable act, and their claim is consequently subordinated.

While mezzanine financing in the Anglo-Saxon legal system (USA, UK) is primarily based on collateral security and the nature of "Debt," in the Continental law system represented by German legislation, this instrument is regulated at the intersection of "corporate partnership" and "law of obligations."

In Germany, the legal basis for mezzanine financing is not defined by a specific statute, but is implemented through two main instruments established by the German Commercial Code (Handelsgesetzbuch – HGB) (German, n.d.) norms: "Silent Partnership" (Stille Gesellschaft) and the Right to Participate in Profits (Genussrechte).

The most common form of raising mezzanine capital in Germany is the "Silent Partnership" (Stille Gesellschaft), regulated under Sections 230–237 of the Commercial Code. The essence of this model is that the

investor contributes capital to the company but remains invisible to external third parties (creditors or customers).

According to Section 230, the capital contributed by the silent partner (mezzanine investor) transfers entirely to the property of the entrepreneur (the company). Unlike the US model, the investor here does not hold a "collateral right" over the company's assets but instead becomes an internal partner of the company.

The hybrid nature of this model is demonstrated in Section 231:

Participation in Profit: The investor has the right to receive a share of the enterprise's profit (a mandatory condition).

Participation in Loss: The most critical aspect is that the investor can participate not only in profit but also in loss. If the company ends the financial year with a loss, the investor's capital contribution is reduced by the amount of that loss. This feature differentiates mezzanine from a simple loan and economically brings it closer to equity capital.

From a legal control perspective, Section 233 prohibits the investor from interfering in the company's management but grants them the authority to examine financial reports and review accounting books (Information Rights). This is similar to the Information Covenants used in the USA.

Pursuant to Section 236, if the company is declared insolvent, the mezzanine investor (provided their contribution has not been entirely eliminated by losses) can claim their remaining funds and appear as a creditor. However, a "subordination agreement" is typically applied in mezzanine transactions. Under this agreement, the mezzanine investor consents to their claims being satisfied after all other creditors but before the shareholders.

Another distinct and widespread form of mezzanine financing in German corporate law is the "Right to Participate in Profits" (Genussrechte or Genussscheine). By its legal nature, this instrument is a classic hybrid instrument positioned between equity capital and debt obligation, possessing a unique legal status.

Unlike the "Silent Partnership," the "Right to Participate in Profits" (Genussrechte) is not regulated in detail as a separate institute within the Commercial Code. Its legal basis relies on the principle of "freedom of contract" enshrined in the German Civil Code.

From the perspective of mezzanine financing, the Genussrechte is distinguished by the following specific characteristics:

1) Absence of Management Rights: The holder of the Genussrechte is not considered a company shareholder. They do not have the right to vote in general meetings or to intervene in the company's management. This feature is particularly attractive to founders who wish to retain control of the company.

2) Priority of Proprietary Rights: Although lacking management rights, the investor, much like a shareholder, has the right to receive a share of the company's net profit. According to the contract terms, this can be a fixed interest rate or a variable payment contingent on the company's financial results.

3) Capital Repayment: Unlike shares, the Genussrechte is typically term-limited. Upon maturity of the contract, the investor has the right to reclaim their contributed capital at the nominal value (sometimes with an additional premium).

To prevent the Genussrechte from becoming a simple debt obligation and to ensure it obtains "mezzanine" status, a special subordination clause is included in the contract. Pursuant to this clause, should the company become insolvent, the claims of the Genussrechte holder are satisfied only after all other creditors (banks, suppliers) have been satisfied, but before the shareholders. It is precisely because of this condition that German banking law and Basel standards recognize funds raised via

Genussrechte as the company's "economic equity."

In conclusion, German legislation has opted to regulate mezzanine financing not through a mechanism of rigid collateral and foreclosure (as in the US model), but through flexible contractual relationships between the investor and the entrepreneur. This approach offers alternative legal solutions for countries belonging to the Continental legal system, such as Uzbekistan.

The German Genussrechte model holds significant importance for Uzbekistan's legislation. This is because the instrument does not require the adoption of a new law but can be implemented through the "freedom of contract" principle within the framework of the existing Civil Code. Specifically, the experience of Genussrechte can be utilized in introducing "Profit-Participating Bonds" or special "Investment Loan Agreements" in Uzbekistan. The aim is to create a subordinated mechanism that guarantees investors a higher dividend from company profits without granting them voting rights, while ensuring subordination in the event of bankruptcy.

The stability of the mezzanine financing market in developed countries is ensured not only by the terms of the transactions but also by regulating the activities of the capital owners – the investment funds. In this regard, the European Union's Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers (AIFMD) (European Union, 2011, June) is the most crucial legal document. Adopted in response to the aftermath of the 2008 global financial crisis, this Directive introduced strict requirements for the activities of mezzanine funds, hedge funds, and private equity funds.

The main objective of AIFMD is to ensure the transparency of funds that invest in non-traditional financial instruments and to prevent systemic risks. The Directive regulates not the funds themselves, but the companies that manage them. Specialized funds engaged in mezzanine financing fall under the category of "Alternative Investment Funds" according to EU legislation, and their managers are required to be licensed based on the requirements of this Directive.

Articles 26–30 of the Directive constitute the key provisions that impose specific restrictions on the activities of Mezzanine and private equity funds. The objective of these norms is to prevent investors from immediately "breaking up and selling off" the company's assets and weakening its financial base after gaining control over the debtor company.

These rules apply only when a Mezzanine or Private Equity fund gains control by acquiring more than 50% of the company's voting shares. The primary focus is on non-listed (i.e., private) companies. The core essence of Articles 26–30 is the introduction of a "24-month freeze" period. Starting from the date the investor acquires control, they are strictly prohibited from taking any action that could damage the company's financial stability for the subsequent two years (24 months).

Furthermore, during this period, Mezzanine funds or the companies managing them are prohibited from making the following three main financial decisions:

Capital reduction: They are not allowed to reduce the company's authorized capital, meaning funds cannot withdraw a portion of the capital they invested in the short term. This serves as a "safety cushion" for the company's creditors (senior banks).

Share buybacks: Operations aimed at the company purchasing its own shares are prohibited, as this also leads to the outflow of capital from the company.

Large dividend distributions: Investors who have gained control are prevented from quickly extracting the company's accumulated reserves or assets in the form of high dividends or other payments.

Articles 22–23 of the Directive impose strict information disclosure obligations on mezzanine funds. Specifically,

funds are required to report regularly to the national regulator (e.g., BaFin in Germany, AMF in France) regarding their investment strategies, key risks, and the extent of financial leverage they employ. Furthermore, funds must provide their investors with detailed information about their methods for asset valuation and their liquidity management system.

In accordance with the Directive's requirement, mezzanine funds must appoint an independent Depositary to hold their assets (cash and securities) and monitor cash flows (Article 21). Additionally, the valuation of mezzanine assets (shares and debt obligations) must be performed by experts who are independent of the fund manager, or by a functionally segregated internal department (Article 19).

A systematic analysis of the foreign models studied reveals not only their achievements but also the limitations regarding their transformation into the national legal system.

The US Model relies primarily on debt instruments and is characterized by a high degree of contractual freedom. Its main advantage is the extreme flexibility of financing terms. However, its primary legal risk is associated with the "Lender Liability" doctrine. If a mezzanine investor interferes excessively in the debtor company's management decisions, the court may recharacterize their status from a creditor to an equity holder and relegate their claims to the lowest priority. For systems like Uzbekistan, where judicial precedent is less developed, this model creates significant legal uncertainty.

The German Model is based on the institution of the "Silent Partnership" (Stille Gesellschaft), bringing mezzanine financing closer to equity. Its advantage lies in the clear statutory definition of priorities and the legally fortified role of the investor in corporate governance. However, this model is less flexible than the US model, and the mechanisms for rapid investment exit (exit strategy) are more complex.

The UK Model relies on "contractual subordination." Its strength lies in creating an understandable environment for international investors through standardized LMA contracts. Nevertheless, the rigid hierarchy within the UK's insolvency legislation compels mezzanine creditors to utilize complex and costly legal instruments, such as the "floating charge."

Doctrinally, two approaches were analyzed in classifying mezzanine financing: as an "independent contract" or as a "mixed contract."

In the author's position, mezzanine financing should be recognized within the civil law system of Uzbekistan as a mixed contract and, simultaneously, as a sui generis (unique) obligation. We provide the following legal grounds for this classification:

Institutional Complexity: A mezzanine transaction encompasses elements of debt under Article 732 of the Civil Code (law of obligations), freedom of contract under Article 354 (subordination agreements), and the transfer of property rights (options). These elements are inseparable and are directed toward a single investment objective.

Uniqueness of Contractual Subordination: The primary feature distinguishing mezzanine from an ordinary loan is its "junior priority." This is not merely a contractual term but a special legal status involving the creditor waiving their rights or limiting them in favor of another creditor.

Therefore, labeling mezzanine financing simply as a "type of loan" overlooks its corporate governance components. Classifying it as a "subordinated loan agreement with elements of investment partnership" accurately reflects its legal nature within national legislation and serves to fill legal gaps when drafting these transactions in practice.

Conclusion

Hybrid financial instruments are an integral part of the modern financial and legal system, and their legal status and regulatory environment vary significantly

depending on the jurisdiction. This study aimed to investigate the complex legal nature of mezzanine financing as a hybrid instrument positioned between "Debt and Equity." The legislation and market practices of developed countries such as the USA, the UK, and Germany were analyzed comparatively.

The results obtained indicate that the effective operation of mezzanine financing relies on three main pillars: statutory regulation, contractual standardization, and institutional oversight.

The analysis revealed a fundamental difference between the Continental (German) and Anglo-Saxon (US/UK) legal systems. While US and LMA standards primarily regulate the relationship through "debt" mechanisms via collateral and priority of claims (subordination), the German institution of "Silent Partnership" brings the financing closer to an "equity" relationship by sharing the company's losses.

The application of LMA standards (specifically the Intercreditor Agreement) fills legal gaps, reduces transaction costs, and increases market confidence through mechanisms like "Payment Blockage" and "Standstill Periods."

The European Union Directive and the US "Equitable Subordination" Doctrine ensure the ethical dimension of mezzanine financing. These mechanisms prohibit investors from selling off assets or gaining an unfair advantage at the expense of other creditors after seizing control of the company.

The importance of mezzanine financing lies in its ability to stimulate innovation, deepen the capital market, and provide flexibility that traditional financing instruments cannot offer. The effective use of this tool is undoubtedly a crucial prerequisite for the diversification and long-term, sustainable development of the country's economy.

As a result of the study, the following author's definition and legal model of mezzanine financing were developed as a scientific novelty:

Mezzanine Financing is a legal relationship aimed at financing the investment projects of business entities, integrating elements of the law of obligations (debt) and corporate law (equity participation), and characterized by contractual subordination (lowering the payment priority) and conversion rights (options).

To establish a comprehensive legal framework for mezzanine financing in the Republic of Uzbekistan, the following specific conceptual amendments are proposed:

1) Within the Civil Code of the Republic of Uzbekistan:

Article 732: An amendment should be introduced to institutionalize the concept of "Subordinated Debt" and its legal status. This would ensure that an agreement between the creditor and the debtor to satisfy debt claims only after other creditors' claims are met carries full legal force.

Article 354: The legal status of the "Intercreditor Agreement" should be formally recognized as part of the principle of freedom of contract. This would allow the mezzanine investor and the bank (senior creditor) to contractually regulate the priority of their respective claims.

2) Within the Law "On Insolvency":

Article 150 (Priority of satisfying creditor claims): A specific tier for mezzanine creditors should be established (e.g., positioned after unsecured creditors but before the shareholders/founders). This provides a guarantee that the investor will not be relegated to the status of an "equity holder" during bankruptcy proceedings.

3) Within the Law "On Joint-Stock Companies and Protection of Shareholders' Rights":

Introduce the institute of "Observer Rights" for mezzanine investors. This would allow the investor to attend meetings of the Supervisory Board and receive information without voting rights. Such a mechanism

ensures the investor's oversight while protecting them from the risks of "Equitable Subordination" found in US practice.

Adapt norms regarding hybrid securities (e.g., new types of convertible preferred shares) to align with the specific characteristics of mezzanine financing.

4) Within the Law "On Limited Liability Companies":

Incorporate the concept of a "Convertible Loan Agreement." This norm would allow a loan received from an investor to be converted into a share of the company's equity (capital) after a certain period or upon the fulfillment of specific conditions, subject to a resolution by the general meeting of the LLC participants.

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