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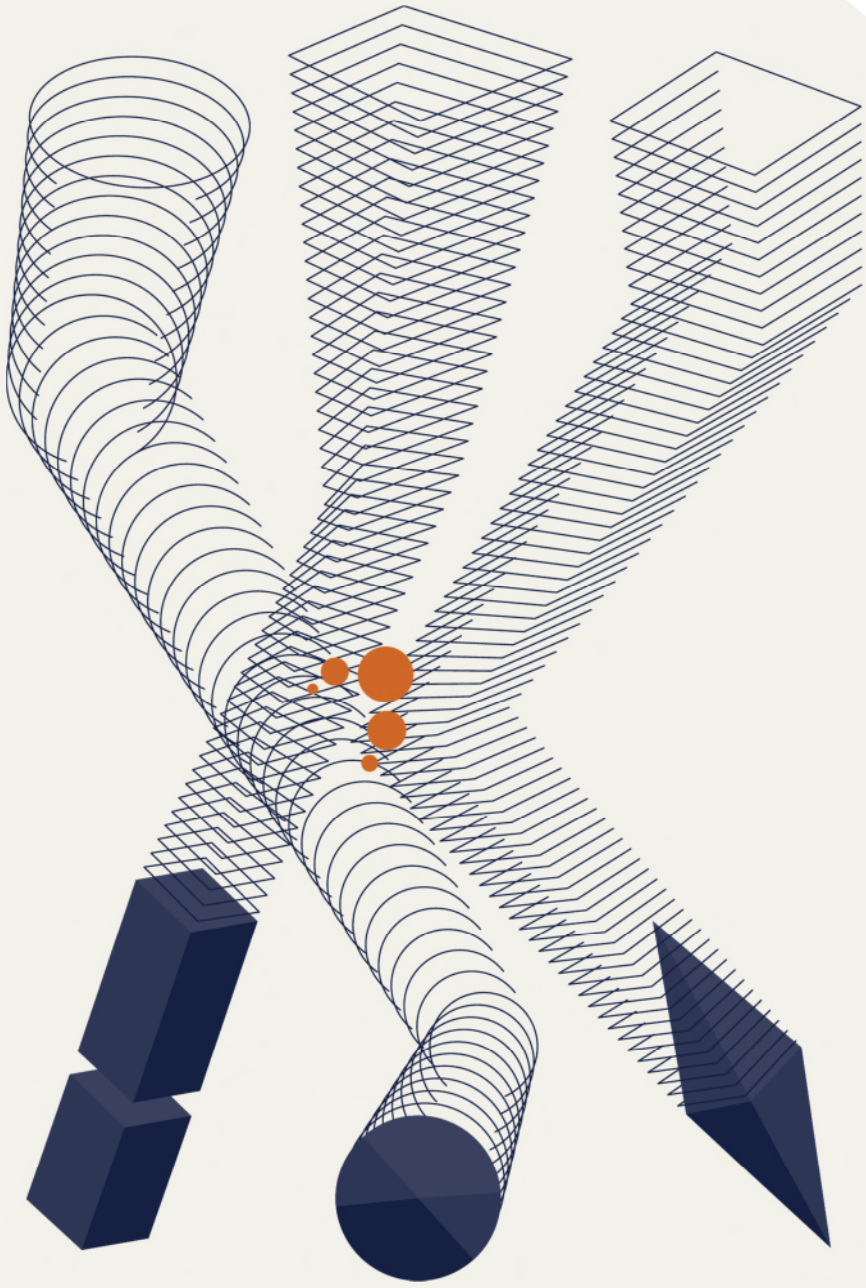

Russia

Real Estate Investment Group

Annual Report 2018

March 2019

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/ Introduction

In the survey for 2018 we discuss the main changes in real estate legislation adopted during the last year in Russia, which are of particular interest to practitioners, namely:

- Public easements regarding linear infrastructure;
- Demolition and legalization of unauthorized buildings;
- State registration through notaries;
- Recommendations of the Plenum of the Supreme Court on conclusion and interpretation of agreements, in particular, preliminary agreements;
- Recommendations of the Presidium of the Supreme Court on changing the permitted use of land;
- Court practice.

1. Public easements regarding linear infrastructure

1.1 General

With effect from 1 September 2018, the Russian legislator has enabled the competent federal or local government bodies (except for Rosavtodor regarding buildings for crossings of motor roads and railway lines, the competent bodies are not yet determined) to establish a public easement ("**Easement**") on public and private land plots upon application and for the benefit of a state or private legal entity (e.g. a legal entity dealing with natural monopolies, communication or public transport) ("**Beneficiary**") for the construction and operation of Linear Infrastructure.

1.2 Procedure for establishment

After the decision on the construction of the Linear Infrastructure and charging the land plots needed for its construction ("**Land Plots**") with an Easement is taken, the Easements will be registered with the Unified State Register of Immovable Property, and, within one month after registration, the Beneficiary and each of the owners of the Land Plots ("**Land Owner**") have to enter into an Easement agreement (suggested by the Beneficiary) which defines the Easement term, the amount of the Easement fee and other obligations of the parties. However, even if a Land Owner does not agree with the terms of the Easement agreement, the Beneficiary is entitled to pay the Easement fee to a notarial escrow account and exercise the rights out of the Easement.

Easements cannot be established in regard to Land Plots granted to citizens for private housing and gardening except for connecting objects on such land to general utilities. There are special requirements for establishing Easements on agricultural Land Plots.

1.3 Rights of land owners

The rights of Land Owners against the establishment of the Easement are limited to the following:

- Challenging the decision on the establishment of an Easement, if it breaches the law and infringes the rights of the respective Land Owner, within thirty days since the date of receipt of the draft easement agreement;
- Requiring the Beneficiary to purchase the Land Plot for a price equivalent to the market value of the Land Plot and reimburse him for the losses suffered if the performance of the Easement significantly impedes the use of the Land Plot (for more than three months regarding Land Plots with residential buildings and for more than one year for other Land Plots);
- Requiring the Beneficiary to agree on certain conditions of the Easement agreement if the Land Owner has not agreed on the terms of the Easement agreement and the Beneficiary has exercised the Easement and paid the Easement fee into a notarial escrow account;
- Demanding in court proceedings the termination of the Easement on certain grounds defined by the law (e.g. breach of procedure on the establishment of the Easement, change of location of the linear infrastructure on new area planning schemes or the Beneficiary's breach of the legal requirements on the exercise of the Easement.

2. Demolition and legalization of unauthorized buildings

2.1 Previous laws and practice

Under the previous laws an unauthorized building ("**Unauthorized Building**") had to be demolished by the builder either voluntarily or upon a decision of the competent court ("**Court**") or the competent local body ("**Local Body**"). It could be retained upon a decision of the Court only in the following events:

- The builder was the owner or proprietor of the land under the Unauthorized Building; and
- The Unauthorized Building complied with all legal requirements and was not in breach with any rights of other persons.

The Local Body could take a decision on demolishing only if the land plot under the Unauthorized Building was not duly granted and this land plot was located (1) within the boundaries of a zone with special terms of use (e.g. sanitary protection zone, water conservation zone, etc.) or (2) in the territory of public use or (3) right of way of infrastructure facilities. In all other cases the decision on demolition had to be taken by the Court.

However, in practice the Local Bodies abused their powers and made the decisions to demolish the Unauthorized Buildings upon requests of owners of infrastructure facilities. In many cases the Unauthorized Buildings were properly built, but located within the boundaries of zones with special terms of use where construction was not permitted. Their owners did not know about the restriction because the official scheme of such zones was not published. Nevertheless, due to violation of the restriction, duly constructed buildings were considered to be Unauthorized Buildings and should be demolished.

2.2 Subject of new laws

2.2.1 General

On 4 August 2018 amendments to the civil and urban laws have taken effect which introduce a new structure for demolishing or legalizing and retaining Unauthorized Buildings. The new structure is aimed at:

- Restricting the powers of the Local Bodies by limiting the cases in which the Local Body may take a decision on the demolition or on the reconstruction of an Unauthorized Building;
- Extending the options for legalizing and retaining Unauthorized Buildings by defining cases in which an Unauthorized Building may be legalized, i.e. reconstructed to bring it in line with the requirements of Russian urban planning laws.

2.2.2 Decision on demolition or reconstruction by court

Under the new laws only a Court may take a decision on demolition or reconstruction with subsequent legalisation ("**Reconstruction**") if:

- The Unauthorized Building is located on private land (except when retaining such building poses a threat to life);
- The ownership to the Unauthorized Building has already been registered with the Unified State Register of Immovable Property or has been acknowledged by Court;
- The Unauthorized Building is a block of flats or residential premises or a religious facility etc.

2.2.3 Decision on demolition or reconstruction by local body

The new law sets forth that an Unauthorized Building may be demolished by the Local Body only if:

- The land plot under the Unauthorized Building was not duly granted; or
- The land plot was located in a territory of public use and its permitted use did not include construction of such building.

The Local Body may take a decision on the Reconstruction of an Unauthorized Building, if:

- There is no construction permit with regard to the Unauthorized Building; or
- The land plot under the Unauthorized Building is located within the boundaries of the zone with special terms of use and its mode does not allow construction of such building on it.

2.2.4 Performance of demolition or reconstruction

Demolition or Reconstruction must be performed within the term mentioned in the relevant decision. If ruled by the Local Body, the term for the demolition may be between three to twelve months and the term for the reconstruction between six months and three years.

Usually, demolition or Reconstruction must be performed by the builder of the Unauthorized Building. However, if the builder cannot be found demolition or Reconstruction may be requested from the owner or user of the land thereunder. If

these persons are also not available, the local government body may perform the Reconstruction itself or, in the event of governmental or municipal buildings may request its performance from the respective land tenant. In the event of Reconstruction, the respective person is entitled to become the owner of the Unauthorized Building.

3. State registration of real estate

3.1 State registration through notaries

Starting from 1 February 2019, if a notary registers an agreement, based on which rights to real estate arise (e.g. a sale and purchase agreement or a mortgage agreement) such notary will be obliged to submit an application for registration to the Unified State Real Estate Register ("**EGRN**"), unless the parties of the agreement expressly wish to submit the application themselves (amendments to Art. 55 of the "Basic Laws on Notaries").

The application must be submitted in electronic form on the same day on which the agreement was notarized or, if this is not possible, within two business days thereafter, at the latest. If an electronic application cannot be submitted for technical reasons the notary will be obliged to submit the application in paper form.

3.2 State duties for registration of a multiplicity of real estate items

In its letters dated 1 February 2018 No. 03-05-06-03/5569, dated 18 June 2018 No. 03-05-06-03/41464 and dated 3 September 2018 No. 03-05-06-03/62685, the Ministry of Finance has clarified the following rules for the occurrence of the state duties for the registration of a multiplicity of real estate items in the EGRN.

3.2.1 Sale and purchase agreement

If several real estate items are sold under one sale and purchase agreement, the state duty must be paid for each item as subject of the registration is the owner-ship to each item. For example, if a building is sold together with the land plot thereunder, the state duty will be RUB 22,000 (if the applicant is a legal entity) multiplied by two.

3.2.2 Lease agreement

On the other hand, if several real estate items (for example, several premises in one building) are leased under one lease agreement the state duty must be paid only once since the subject of the state registration is the lease agreement itself and not each of the leased real estate items.

The state duty for the registration of the lease agreement is RUB 22,000 (if the applicant is a legal person). If an additional agreement to the lease agreement is registered the state duty is only RUB 1,000 (if the applicant is a legal person).

3.2.3 Mortgage agreements

In the event of registration of an amendment to a mortgage agreement under which the number of the mortgaged real estate items is increased the following state duties must be paid if the applicant is a legal entity:

- State duty in the amount of RUB 4,000 for the registration each new mortgaged real estate item; and
- State duty in the amount of RUB 600 for the change of the record on existing mortgage in the EGRN.

4. Recommendations of the plenum of the Supreme Court on conclusion and interpretation of agreements

On 25 December 2018 the Plenum of the Supreme Court of the Russian Federation ("**Plenum**") has adopted recommendations for the court practice on the execution and interpretation of agreements. It is evidence of a great progress of the Russian court system that, regarding the interpretation of agreements, the recommendations emphasize to identify the will of the parties, rather than to rely on the wording of the agreements. The recommendations of the Plenum contain also important clarifications regarding the legal concept of "warranty of circumstances" which is comparable to the English law concept of "representations and warranties" and is meanwhile often used in business trans-actions which are governed by Russian laws. Other noteworthy statements concern the preliminary agreement, the framework agreement and the public agreement, all of which are legal tools often used in Russia related business transactions. Recommendations consolidate the already established court practice on some issues, as well as clarify issues that cause difficulties and contradictions in court. All recommendations of the Plenum contribute to a further increase of legal certainty for foreign investors. Below we have summarized the most important recommendations.

4.1 Warranty of circumstances

Agreements often contain clauses in which a party ("**Warrantor**") grants to the other party an explicit warranty ("**Warranty**") on circumstances which are relevant to the conclusion, performance or termination of the agreement. A Warranty may be granted also by a third party which has a lawful interest in the respective agreement. If an event is, at the same time, a breach of a Warranty and a breach of another obligation under the agreement, the consequences for both apply simultaneously. Therefore:

- If, under a Warranty, a seller has provided to a buyer information on characteristics of the goods with which similar goods mostly do not comply and such information turns out as untrue, along with the rules on liability for untrue Warranty, also the provisions on the quality of the goods apply;
- The same is true if under an agreement on the sale of shares in a joint stock company or a limited liability company the seller provides information regarding the characteristics of the company and the stock of its assets;
- If the Warranty does not directly concern the item of the agreement, but other relevant circumstances (e.g. the financial standing of the Warrantor or a third per-

son, the existence of licenses, the structure of corporate control, the absence of indications for the qualification of the agreement as a significant transaction, requiring corporate approval, or the absence of a conflict of interests etc.), along with the rules on liability for untrue Warranty, also the general provisions on the breach of obligations under the agreement apply.

The following is said regarding the subjective prerequisites of the parties:

- If the Warrantor carries out entrepreneurial activity, or the Warranty is granted under a shareholders' agreement or an agreement on the sale of shares in a joint stock company or a limited liability company, in the event of untruth of the Warranty, the Warrantor bears liability irrespective of its fault (unless otherwise agreed by the respective parties);
- It will be assumed that the other party has trusted in the truth of the Warranty;
- Regarding a relief from, or a reduction of its liability, the Warrantor may not refer to negligence of the other party (i.e. because it has not itself revealed the untruth of the Warranty).

4.2 Interpretation and qualification of agreements

Regarding interpretation and qualification of agreements, the Recommendations attach importance on upholding the respective agreement and identifying the will of the parties, rather than on sticking at the wording of the agreement:

- The determination of the legal type of an agreement should be made on the basis of characteristics of the agreement provided by the law and the essence of the legal provisions concerning the respective type, independently from the title of the agreement and the wording used for the designation of its parties and the description of the actions for the performance of the obligations under the agreement;
- Interpretation should avoid that any party gains an advantage from its unlawful or unfaithful behavior and should not lead to an understanding which the parties obviously have not meant;
- A clause may be interpreted by comparing it with the other clauses and the concept of the agreement as a whole. A court should focus on the systematic connections of a clause and in consideration of the fact that all clauses are agreed parts of one agreement;
- Interpretation should be conducted in consideration of the aim of the agreement and the essence of the laws which apply to the respective type of the agreement;
- If validity or conclusion of an agreement is in dispute, the court should assume the validity or conclusion as long as there is no evidence for the contrary. If a clause allows several alternatives of interpretation priority should be given to an alternative which would lead to the lawfulness or the conclusion of the agreement;
- Unclearness of provisions of an agreement will be at the expense of the party which has drafted the agreement. It will be assumed that such party professionally carries out the activity, within the sphere of which the agreement has been conclud-

ed (e.g. the bank regarding a credit agreement, the leasing company regarding a financial lease agreement or the insurance company regarding an insurance agreement etc.).

4.3 Lack of registration of real estate lease agreement

Agreements on the lease of real estate with a term of one year or more are subject to registration in the Russian real estate register EGRN. Regarding the consequences of the lack of registration, the following was set out:

- The rights and obligations provided in the lease agreement apply to both parties. In particular, the parties are obliged to arrange for the registration of the lease agreement;
- The lease agreement entails no legal consequences to third parties which do not know and must not know of the existence of the lease agreement.

In the light of the above, in the event of a change of the owner of the real estate, the rights and obligations under the unregistered lease agreement will not be transferred to the new owner if he does not know and must not know of the existence of the lease agreement.

4.4 Preliminary agreement

4.4.1 Requirements to contents

A preliminary agreement is an agreement under which the parties assume the obligation to enter into an agreement (main agreement), on the terms and conditions agreed upon in the preliminary agreement.

In order to recognize a preliminary agreement as concluded it is sufficient that it describes the item of the main agreement or provides for conditions which enable its determination. The lack of other essential conditions, on its own, is not a reason for considering the preliminary agreement as not concluded. So if a preliminary agreement on the lease of a building does not contain a clause on the amount of the rental payments, the agreement is concluded. The parties may agree on the rental payments in the main agreement and, if they do not, may turn to the competent court.

A preliminary agreement or a main agreement may be entered into even if, upon signing of the respective agreement, the principle obligation under the main agreement (e.g. the handing of goods or the rendering of services) cannot be fulfilled. In particular, a sale and purchase agreement or a preliminary agreement may be entered into if the purchase item will be created, registered or acquired by the seller in future.

The Plenum has pointed out that an agreement titled by the parties as a “preliminary agreement” which provides for the entering into an agreement on the sale of a future item has to be re-qualified as the (main) sale and purchase agreement, if it provides for the buyer’s obligation, prior to the entering into the main agreement, to pay the purchase price or a substantial part thereof. In our view, the recommended re-qualification does not apply if the parties of a preliminary agreement have agreed

that the future buyer is obliged to provide to the future seller a security payment for the performance of its obligation to enter into the main agreement, which later will be set off against the purchase price.

4.4.2 Enforcement of obligation to enter into main agreement

If one of the parties fails to comply with its obligation to enter into the main agreement, then such party may be enforced thereto by a competent court. The Plenum explained that this option is available only for the party of the preliminary agreement that took steps toward the conclusion of the main agreement within the time limit set by the preliminary agreement. A claim with the demand to conclude the main agreement may be submitted to the court only within six months after the expiry of the term for its conclusion.

4.4.3 Security for performance of obligations

The Plenum refers to the deposit („zadatok“) („Deposit“), a special type of money deposit, which may be used for securing the parties‘ obligations to enter into the main agreement. It mentions that, if the Deposit had to be provided by the party being obliged to make payment under the main agreement, after its signing, the Deposit will be set off against the payment obligation. If the Deposit had to be provided by a party not being obliged to make payment under the main agreement, after its signing, the Deposit, in general, must be reimbursed to such party.

However, in many preliminary agreements, the Deposit is not used as security as the party which has received a Deposit, in the event of not performing its obligation to enter into the main agreement, is obliged to pay to the other party the double amount of the Deposit. Often the parties prefer to agree on a money deposit which they design independently from the legal provisions on the Deposit.

4.4.4 Framework agreements

Parties of a longer business relationship often enter into a framework agreement which provides for general conditions of the co-operation, e.g. organizational, marketing and financial conditions. Specific conditions will be later agreed in agreements, or applications or other statements. E.g. framework agreements may govern the supply of goods through a longer term. Such framework agreements often contain general provisions on the price for certain goods, the delivery conditions, liability of the parties and the legal venue. The concrete purchases are subject to concrete agreements which provide for the quantity of the goods and the calculation of the purchase price.

The Plenum mentioned that the general conditions of the framework agreement should be considered parts of agreements which comply with the intentions of the parties expressed in the framework agreement, unless otherwise agreed by the parties or following from the essence of the respective obligations. A reference in the agreements to the framework agreement is not necessary.

4.4.5 Public agreement – applicability of benefits to businesses

The Plenum has recommended to apply the benefits of the concept of the public contract ("**Public Contract**") also to businesses (i.e. legal entities and individual entrepreneurs). The recommendation is, in particular, important for investors desiring to enter into agreements with public utility providers as such public utility providers are obliged to enter into a service agreement with the investor and are limited in applying different prices from the investors.

5. Recommendations of the Presidium of the Supreme Court on changing the permitted use of land

5.1. Background

Under urban planning laws the permitted use for each land plot is specified in the urban planning rules for such land plot. The planning rules are established as part of the land use and construction rules which, in general, must be adopted by the local authorities for each settlement and territory.

The types of the permitted use can be classified as follows:

- Main types of permitted use;
- Conditionally allowed types of permitted use (types of use allowed only under special conditions); and
- Supplement types of permitted use which are allowed only as supple-mental to the main and conditionally allowed use.

As a basic rule, the owner or user of a land plot may choose any of the main types of permitted use at its own discretion. He may also change one main type to the other, provided that such change complies with technical safety regulations for the land plot. However, a change of a main type to one of the conditionally allowed types requires the decision of the local authorities.

5. 2 Recommendations of the Supreme Court

On 14 November 2018 the Presidium of the Supreme Court has adopted recommendations for the court practice on the change of the types of the permitted use of land plots. The adopted recommendations include the following:

- If the land use and construction rules are duly adopted by the local authorities the owner of a private land plot may choose any of the main and supplemental types of the permitted use provided for such land plot in those rules without any additional consent of the local authorities;
- If a land plot was leased out for a specific permitted use type (e.g. the construction of a building with four to five floors) on the basis of a public auction the lessee may not change the permitted use type (e.g. to the construction of a building with five to nine floors);

- The lessee of a state or municipal land plot may not change one main type of the permitted use to another main type of permitted use provided for such land plot in the urban planning regulation, in particular, if such land plot was leased out for a specific purpose;
- It is not allowed to choose a supplemental type of permitted use as the main type of use for a land plot; a supplemental type of permitted use may only be chosen as an additional type of use to either a main or conditionally allowed type of permitted use;
- If, regarding an agreement on the lease of a municipal land plot, no type of permitted use was determined, the local authorities may not refuse a lessee's request for determining such type of permitted use;
- It is not allowed to change the main type of permitted use of a land plot to one of the conditionally allowed type of use if it would violate the limits of the allowed construction on such land plot (e.g. maximal and minimal allowed areas of land plots for such type of use); on the other hand, the user of the land plot may apply for the permit to deviate from the limits of the allowed construction and, after such permit is granted, apply once again for the change of the type of permitted use.

/ 6. Court practice

6.1 Lessor's rent increase during lessee's unchallenged use after lease expiry as acting in bad faith (Resolution of Supreme Court No. 308-ES17-10134 in case No. A32-8/2016 dated 22 November 2018)

In 2016-2018 the arbitrazh courts including the Supreme Court have considered the dispute between the City of Kransnodar ("Lessor") having leased out premises to the Kransnodar Bar Association ("Lessee"). Despite the expiry of the lease in 2013, the Lessee has continued the use of the premises.

Since the Lessor has not challenged the further use of the premises by the Lessee, the lease agreement was deemed concluded for an indefinite time period pursuant to Art. 621 (2) of the Civil Code RF. According to Art. 610 of the Civil Code RF a lease agreement concluded for an indefinite time period may be terminated by either party with three months' notice.

In the given situation, the Lessor repeatedly requested from the Lessee a significant increase of the lease rent on the basis of the general right of the municipal entities to establish the rent rates for the lease of the municipal property. The Lessee did not comply with the Lessor's request and also several times successfully challenged the rent rate in the court due to the fact that the Lessee as Bar Association was entitled to apply the special coefficient of 0.1 to the rent rate. After that the Lessor terminated the lease agreement with a three months' notice and claimed compensation for damages based on the increased rent.

This dispute has passed all instances including that of the Supreme Court which has returned it back to the first instance. In the second round the dispute has reached the Supreme Court again. The courts could not agree on whether the Lessor acted in bad faith when it claimed the higher rent (this view was supported by the courts of the second and third instances) or simply executed its legal right to gain more profit from its property (this view was supported by the court of the first instance and the Supreme Court). The courts of the second and third instances pointed out, that the Lessor has terminated the lease agreement only with the intention to receive the unjustified higher rent after the Lessee has won several court cases regarding establishment of the beneficial lower rent. The Supreme Court returned the case again to the first instance for the third round of new consideration.

6.2 Seller's pre-contractual obligation to inform the buyer of non-registered encumbrances (Resolution of the Supreme Court No. 127-KG18-20 dated 2 October 2018)

A private person has sold a land plot which is located on the territory of a military unit of the Ministry of Defence RF to another private person. This military unit restricts the access to the land plot. The information about restricted access and specific location of the land plot was not registered in the Real Estate Register.

The seller has not informed the buyer of the aforementioned encumbrance of the land plot. The court of the first instance has satisfied the buyer's claim on the termination of the sale and purchase agreement, based on Art. 37 (3) of the Land Code RF which provides that the buyer may claim termination of the sale and purchase agreement and compensation for damages if the seller has provided to the buyer deliberately false information on the land plot including the encumbrances thereof.

The court of the second instance has rejected the decision of the first instance court and dismissed the claim, based on the consideration that the buyer should have conducted a due diligence review and, therefore, could have been aware of the restrictions in question.

The Supreme Court has supported the view of the court of the first instance and stated that the seller was obliged to inform the buyer on all existing restrictions regarding the use of the land plot, even if they were not registered in the EGRN. The obligation comprises also information on the use of the neighbour land plots which may affect the use of the land plot being subject of the sale to the buyer. The case was sent back to the court of the second instance for new consideration.

6.3 Satisfaction of debts of a physical person by selling its sole residence (Resolution of the Supreme Court No. 305-ES18-15724 in case No. A40-67517/2017 dated 29 November 2018)

An individual entrepreneur ("**Debtor**") was unable to satisfy his debts (in particular, an obligation to repay a loan in the amount of approx. RUB 13 mln After insolvency proceedings were opened, the Debtor claimed to exclude his only residence (a five rooms apartment in the Moscow region) from the insolvency assets.

The courts of two instances have agreed with the Debtor's claim to exclude the sole residence from the insolvency assets as under Art. 446 of the Civil Process Code RF and Art. 213.1. and 213.25 (1 and 2) of the Insolvency Law the only residence of a physical person may not be sold to satisfy his or her debts in the course of law enforcement procedures.

However, the Supreme Court has discovered that the Debtor has arranged for disposing of his other real estate so that the apartment in question became his only residence. Moreover, the Supreme Court referred to the Resolution of the Constitutional Court No. 11-P dated 14 May 2012, according to which the legal protection of the only residence of a physical person from being sold for the satisfaction of his or her

debts applies only to residences in quantity and quality necessary to satisfy the reasonable needs for accommodation. Residences which exceed the reasonable needs may be sold for satisfying the debts and purchasing a reasonable residence.

For the above reasons the Supreme Court has disagreed with the judgements of the lower courts and returned the case back to the first instance for new consideration.

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