

# CLIENT UPDATE

## FIRST BUNDLE OF AMENDMENTS TO THE RUSSIAN CIVIL CODE IS ADOPTED

### MOSCOW

Dmitri V. Nikiforov  
dvnikiforov@debevoise.com

Alan V. Kartashkin  
avkartashkin@debevoise.com

Alyona N. Kucher  
ankucher@debevoise.com

Natalia A. Drebezgina  
nadrebezgina@debevoise.com

On December 18, 2012, the draft Federal Law on Amendments to Chapters 1, 2, 3 and 4 of Part One of the Civil Code of the Russian Federation had its third reading in the Russian State Duma. On December 26, 2012, it was further approved by the Federation Council. To come into effect, the draft law must be signed into law by the President of Russia.

It is important to note that the amendments to the Civil Code will be phased in gradually. On April 27, 2012, the State Duma adopted the entire bundle of amendments to the Russian Civil Code in the first reading. However, on November 16, 2012, the State Duma adopted Resolution No. 1150-6 GD on changes to the procedure for the consideration of the Draft Civil Code. Pursuant to this Resolution, the amendments will be split into parts and adopted as separate draft laws in the course of 2013. The adoption of the next bundle of amendments to Chapter 4 (Legal Entities) is already scheduled for January 2013.

In this overview we discuss the first bundle of amendments; specifically, those made to Chapters 1, 2, 3, and to 4 – but only in respect of those provisions that relate to farm smallholdings – of Part One of the Civil Code.

The adoption of this draft law is a first practical step in reforming Russian civil law. The majority of changes (with the exception of

those specifically noted below) **will become effective on March 1, 2013.**

The amendments will generally apply to legal relationships that have arisen after the effective date of the above federal law.

For any relationships already in place prior to this date, the amendments will apply only to those rights and obligations that arise after such date.

Changes have been made to a number of core provisions of the Civil Code (“fundamental principles of civil legislation,” “abuse of rights,” “grounds for the emergence of civil rights and obligations,” etc.). Provisions relating to the legal capacity of individuals, i.e., natural persons, have also undergone significant changes.

Below we provide a brief analysis of what is new.

## **PRINCIPLE OF GOOD FAITH**

The **principle of good faith** in the creation, exercise or protection of civil rights and performance of civil obligations will now be codified in the law, as well as a **prohibition on benefiting from one’s unlawful or bad faith behavior**. Any intentional exercise of civil rights in bad faith will be deemed to be an abuse of rights.

The principle of good faith has been recognized by the courts in the past, including the Higher *Arbitrazh* Court of the Russian Federation,<sup>1</sup> and parties that have been in breach have been held liable for bad faith behavior.

However, until now it has never been enshrined in law.

The principle of good faith is closely related to the prohibition on benefiting from bad faith or unlawful behavior (e.g., failure to perform an obligation means that the obligor is in effect using another person’s funds, and the terms and conditions of any such use may not be more favorable than those available to transacting parties on legal grounds). Such an approach has also been recognized in court practice,<sup>2</sup> and the amendments now incorporate this in the law.

---

<sup>1</sup> See Ruling No. 12499/11 of the Presidium of the Higher *Arbitrazh* Court dated February 21, 2012 in Case No. A40-92042/10-110-789 (this Ruling provides for the possibility to apply for review of other court judgments previously handed down in similar cases).

<sup>2</sup> See Ruling No. 12035/11 of the Presidium of the Higher *Arbitrazh* Court dated February 14, 2012 in Case No. A64-4929/2010; Ruling No. 11680/10 of the Presidium of the Higher *Arbitrazh* Court dated January 13, 2011 in Case No. A41-13284/09.

These innovations are of vital importance and bring Russian rule of law closer to the developed European legal systems where courts have more flexibility in evaluating the behavior of parties exercising their civil rights or performing their obligations. For example, if a party displays bad faith behavior in the course of concluding or performing a contract, which is a breach of the law *per se*, this allows the other party to protect its rights and lawful interests breached by such bad faith behavior, even absent other breaches by the party acting in bad faith.

### ACTING IN CIRCUMVENTION OF THE LAW

“Acting in circumvention of the law with unlawful intent” has also been recognized as a form of **abuse of right**.

Prior to the adoption of the amendments in question, acting in circumvention of the law was already qualified by the courts as an abuse of right,<sup>3</sup> but it was never codified in the law.

It is worth noting that the amendments made contain no criteria for qualifying any particular behavior as “acting in circumvention of the law”. It appears that of key significance will be proving whether or not a party showed unlawful intent to circumvent the law.

### IMPLICATIONS OF ABUSE OF RIGHT

With this amendment abuse of right can now result not only in a full or partial loss of legal remedies to protect such right, but in the **obligation to compensate the losses suffered by the party** whose rights have been breached. If a party abuses its right by acting in circumvention of the law with unlawful intent, other consequences contemplated by the law will also apply (e.g., declaring a transaction invalid).

---

<sup>3</sup> Due to the absence of any criteria in the law for determining whether certain behavior is “in circumvention of the law,” the courts have taken various different approaches in deeming actions to be such: Information Letter No. 146 of the Presidium of the Higher *Arbitrazh* Court dated September 13, 2011 (in respect of a provision in a loan agreement covering “compound interest,” i.e., interest on accrued interest); Ruling of the Federal *Arbitrazh* Court of West Siberia District dated June 5, 2012 in Case No. A70-11050/2011 (claim to amend the terms and conditions of an agreement for the lease of land related to its intended and permitted use with a view to circumventing the rules on provision of land plots for construction purposes); Ruling of the Federal *Arbitrazh* Court of Volga District dated August 8, 2011 in Case No. A06-4967/2010 (recognition by an arbitral tribunal of title to unauthorized construction with a view to circumventing the procedure of recognition of such title in court and the requirements of the law in respect of state registration of title to immovable property), etc.

The possibility of applying such consequences was previously based on the relevant Information Letter of the Higher *Arbitrazh* Court.<sup>4</sup> For example, the Higher *Arbitrazh* Court ruled that if a party abused its right in the course of conclusion of a transaction, the transaction can be declared invalid on the grounds of being inconsistent with the law (Article 168 of the Russian Civil Code). In issuing this letter the Higher *Arbitrazh* Court significantly broadened the scope of application of Article 10 of the Russian Civil Code at the time.

With these amendments to the above Article, existing practice has now been incorporated in the law.

## PRINCIPLES OF STATE REGISTRATION OF RIGHTS TO PROPERTY

The basic principles of state registration of rights to property now appear in a new Article 8<sup>1</sup>.

The most noteworthy among them are the following:

- *Mandatory legal check* of grounds for registration by the competent agency for state registration;
- *Principle of public accuracy of the state register* (i.e., a person who is aware of inaccuracies in the register cannot refer to it as proof of his good faith; e.g., such person cannot be deemed a *bona fide* purchaser);
- Opportunity for a person with a previously registered right to enter a *note of objection* in the register (such person must challenge the registered right in court within three months from the entry of such note in the register, otherwise such note will be removed);
- Opportunity for a person challenging a registered right to enter a *note of legal dispute* in respect of such right.
- Etc.

## STATE REGISTRATION OF TRANSACTIONS WITH IMMOVABLE PROPERTY

The rules of state registration of transactions with immovable property **will no longer apply to agreements concluded after March 1, 2013**. Thus, the following agreements that

---

<sup>4</sup> Information Letter No. 127 of the Presidium of the Higher *Arbitrazh* Court dated November 25, 2008: Overview of the Application of Article 10 of the Russian Civil Code by *Arbitrazh* Courts.

are subject to registration according to the currently existing text of the Civil Code will no longer be subject to registration:

- Purchase and sale agreements in respect of residential premises;
- Purchase and sale agreements in respect of businesses;
- Gift deeds in respect of immovable property;
- Contracts of annuity in respect of immovable property;
- Lease agreements in respect of immovable property for a term of more than one year;
- Lease agreements in respect of businesses.

Previously, these agreements were generally considered to have been concluded upon their state registration. In practice, this gave rise to numerous risks (e.g., a contract that had not been registered, but was effectively being implemented by the parties could be declared not to have been concluded by the courts, which automatically deprived the parties of protections of their rights under contract<sup>5</sup>).

### **INACCURATE INFORMATION ON PLACE OF RESIDENCE**

The risk arising from any inaccuracy in the information on the place of residence of an individual provided by him to his creditors and other persons is now placed on **the individual**.

Therefore, notices sent to his attention to the address specified by him will be deemed to have been served regardless of whether he actually resides at such place.

### **LIMITED CAPACITY**

It is now possible to declare a person of unsound mind as having limited capacity<sup>6</sup> **if he/she can understand the consequences of his/her actions or be in control of them only with the help of other persons**.

---

<sup>5</sup> For purposes of illustration, see Ruling No. 9940/07 of the Higher *Arbitrazh* Court dated August 22, 2007 in Case No. A40-39856/2006-50-312 (in this case the Higher *Arbitrazh* Court upheld the rulings of the lower courts to the effect that an apartment purchase agreement had not been concluded since it had not undergone state registration; although one of the parties to the agreement had performed its obligation to transfer the apartment, it could not require the other party to perform under such agreement).

<sup>6</sup> The law previously **only** provided for such persons to be declared totally incapacitated, thus depriving them of any opportunity to enter into civil law relations. However, a person declared by a court as having limited capacity may enter into certain transactions on his own behalf (e.g., transactions involving his earnings, scholarship or minor household transactions, etc.).

The need for the amendments arose when the Constitutional Court of the Russian Federation issued a ruling<sup>7</sup> declaring that the applicable provisions of the Civil Code were inconsistent with the Russian Constitution. Pursuant to the position of the Constitutional Court, in determining whether a person was incapacitated or not the respective provisions of the Civil Code did not permit any differentiation between the civil law implications of the existence of a mental disorder suffered to varying degrees, depending on actual impairment of the ability to understand the consequences of one's actions or be in control of them.

This amendment **will take effect on the second anniversary** of the entry into force of the Federal Law on Amendments.

\* \* \*

Please do not hesitate to contact us if you have any questions.

January 2, 2013

---

<sup>7</sup> Ruling No. 15-P of the Constitutional Court dated June 27, 2012 in the Case on the Constitutionality Test in Respect of Articles 29.1 and 29.2, Article 31.2 and Article 32 of the Russian Civil Code brought by Ms. I. B. Delovaya.