

Client Update

Top 10 Legal Developments of 2017 in Russian Real Estate, Construction and Infrastructure Market

This Client Update provides an overview of the most significant legal developments of 2017 in the Russian real estate, construction and infrastructure sectors:¹

LEGISLATION

DRAFT BILLS

1. Civil Code Reform in Respect of the Definition of Immovable Property
2. Blockchain Technology in Immovable Property
3. Determination of “Rules of the Game” for Apartments Turnover
4. Changes in Regulation of Unauthorized Construction
5. Establishment of Procedure for Facility Demolition and Simplification of Procedure for Construction of Individual Housing Facilities
6. Legislative Framework for Special Investment Contracts
7. Preliminary Works prior to Obtaining Construction Permit

COURT PRACTICE

8. Withdrawal of Consent to Sublease by Lessor
9. Termination of Sale and Purchase Agreement if Purchase Price Has Not Been Paid
10. Invalidation of Lease Agreement Resulting from Significant Overstatement of Foreign Currency Lease Rates

¹ For similar annual overviews prepared by Debevoise & Plimpton LLP in 2013-2016, see:
<https://www.debevoise.com/insights/publications/2014/03/top-10-legal-developments-in-russian-real-estate>;
<https://www.debevoise.com/insights/publications/2014/12/top-10-legal-developments-in-the-russian>;
<https://www.debevoise.com/insights/publications/2015/12/top-10-law-developments-in-real-estate-practice>;
<https://www.debevoise.com/insights/publications/2016/12/top-10-legal-developments>.

LEGISLATION

The most important legislative developments of 2017 are described in our prior client alert titled “*Top Five Legal Developments in the Russian Real Estate Market in the First Half of 2017*”,² and include the reform in self-regulation of construction, a prohibition on offshore companies engaging in privatization of state-owned and municipal immovable property and new rules for determination and development of aerodrome environs.

DRAFT BILLS

1. Civil Code Reform in Respect of Definition of Immovable Property

The Ministry of Economic Development of the Russian Federation has developed a draft law³ significantly reforming fundamental concepts and principles of the immovable property turnover. The most important changes are listed below:

- immovable property will include land plots, subsoil blocks and buildings, and a building will mean a construction where at least two premises and/or car parking spaces can be arranged;
- structures (*i.e.*, constructions where no premises or car parking spaces as independent subjects of the right can be arranged) can be classified as immovable property if they (i) are inseparable from land, (ii) have independent commercial importance and (iii) can be a subject of civil law relations separately from other things. The Government of the Russian Federation will prepare a list of types of structures not having the attributes of immovable property;
- prior to registration of title to a building or a structure meeting the criteria of immovable property or registration of title to the premises or car parking spaces in a building, such building or structure will be deemed an inseparable improvement of the land plot, *i.e.*, it will constitute an integral whole with the land plot (principle of unanimity of fate of the land plot and the property located on it);
- owners of premises and car parking spaces in a building will have joint ownership of the communal facilities (the list of which will be set forth in the Russian Civil Code) unless otherwise stipulated by the law (currently, such a rule is expressly provided by the law for residential premises only);
- the concept of immovable property improvements will be introduced; the procedure and criteria for constituting immovable property items, except for land plots, the procedure and criteria for dividing immovable property, the procedure and conditions for making agreements on forming immovable property, the criteria for easement of buildings,

² See <https://www.debevoise.com/insights/publications/2017/09/top-five-legal-developments-in-the-russian>.

³ See Draft Federal Law on Amendments to the Civil Code of the Russian Federation (as of the date of this Client Update, the draft law has not been introduced in the State Duma): <http://regulation.gov.ru/p/62515>.

structures or premises will be established; the regulation of registration and turnover of a terraced house will be introduced; and the specifics of forming, changing and discontinuing a single immovable property complex will be determined.

2. Blockchain Technology in Immovable Property

An experiment is planned in Moscow from January 1 to July 1, 2018, regarding the use of blockchain technology for keeping the Unified State Register of Immovable Property (EGRN), registration of title to real property, cadastral registration and provision of data contained in the EGRN.⁴

The participants of the experiment will include the Russian Ministry of Communications and Mass Media, the Federal Service for State Registration, Cadastre and Cartography, the Federal Tax Service, the Moscow Government, PJSC Sberbank, PJSC Rostelecom as well as individuals and legal entities. The Russian Ministry of Economic Development will analyze the results of the experiment and will report to the Russian Government by September 1, 2018.

Use of blockchain technology for immovable property registration is expected to significantly reduce registration timelines, decrease the number of bureaucratic procedures, enhance transparency and reduce the risk of abusive practices in the registration of title and transactions in the EGRN.

Based on results of the experiment, a decision will be made on whether the changes in the law with regard to implementation of blockchain technology for keeping the EGRN and exercising various registration activities are reasonable.

3. Determination of “Rules of the Game” for Apartments Turnover

In October 2017, the Russian Ministry of Construction published a draft law⁵ that is intended to fill a gap in the law and set the criteria and principles for turnover of apartments, which are widespread on the real estate market. Apartments are supposed to meet the following criteria:

- structurally detached premises in a multifunction building (which itself is not defined);
- ability to directly access common areas in such building; and
- intended for accommodation of individuals and satisfaction of their domestic needs.

⁴ See Draft Regulation of the Government of the Russian Federation on Experimental Use of the Blockchain Technology in the City of Moscow: <http://regulation.gov.ru/p/74195>.

⁵ See Draft Federal Law on Amendments to the Civil Law of the Russian Federation and Certain Legislative Acts of the Russian Federation in respect of Regulation of Certain Legal Relations Arising out of Construction of Multifunction Buildings (as of the date of this Client Update, the draft law has not been introduced in the State Duma: <http://regulation.gov.ru/p/73980>); the Ministry of Economic Development has not supported this draft law due to lack of clear definition of the subject of regulation.

Housing relations with regard to such premises and common property in multifunction buildings will be regulated by the Housing Code of the Russian Federation.

Owners of premises in a multifunction building will jointly own the communal facilities, including premises intended for serving several premises in the building, other premises not owned by certain owners, roofs, equipment, enclosing supporting and non-supporting structures, and the land plot on which the building is located.

Owners of premises in a multifunction building are required to select whether the building will be managed:

- by the owners of the premises (regardless of the number of premises in the building);
- by a partnership of immovable property owners; or
- by a management company.

The draft law contains transitional provisions, including those providing for the recognition of previously built premises of similar characteristics as apartments. Thus, owners of nonresidential premises in a building commissioned prior to January 1, 2019 are entitled to reregister nonresidential premises as apartments by December 31, 2021 in accordance with the procedure provided by a regulatory act of the constituent entity of the Russian Federation where the building is located.

Such regulatory act will set the requirements for nonresidential premises which can be reregistered as apartments. Reregistration of nonresidential premises as apartments will be permitted if:

- requirement to ensure safety of residents of such premises and safe operation of the premises is envisaged; and
- the building does not contain nonresidential premises used for conducting activities dangerous for life or health.

The land plot on which the building is located where nonresidential premises are reregistered as apartments as well as other immovable property that is part of such building will be common property of the owners of premises in such building.

4. Changes in Regulation of Unauthorized Construction

Fundamental changes in the regulation of unauthorized construction are expected. A draft law⁶ which is being prepared for the first reading in the State Duma suggests the following amendments:

- a building or structure built with violations specified in the law is an unauthorized construction only if the applicable construction requirements (i) existed as of the

⁶ See Draft Law No. 301924-7 on Amendments to the Civil Code of the Russian Federation (in respect of Specifying Provisions on Unauthorized Construction): <http://sozd.parlament.gov.ru/bill/301924-7>.

commencement date of construction and (ii) are effective as of the date when the unauthorized construction is revealed. Operation of an unauthorized construction is not allowed;

- if an owner erected a building or a structure based on the applicable approvals and/or permits, but violated limitations on the use of the land plot which the owner could not know or should not have known about, such building or structure cannot be deemed an unauthorized construction;
- a possible alternative to demolition of an unauthorized construction is to bring it into compliance with the set parameters;
- the law distinguishes between mandatory demolition of an unauthorized construction and an option of choosing between demolition and bringing the construction into compliance with the requirements in the event of making a decision with regard to the unauthorized construction in accordance with the administrative procedure;
- no decision regarding demolition of an unauthorized construction or bringing it into compliance with the requirements can be made in accordance with the administrative procedure if (i) the title to such construction is registered in the EGRN or acknowledged by a court, or (ii) a court has previously handed down a judgment to reject demolition of construction;
- a purchaser of a building or structure, the title to which has been previously registered, where a decision is made on its demolition or bringing the construction into compliance with the requirements, will be entitled to claim compensation of the incurred losses from the treasury of the Russian Federation.

Losses will include: (i) the market value of the facility (in the event of demolition) or the difference between the market value of the facility prior to bringing it into compliance with the requirements and the market value of the facility after that; (ii) losses in connection with the facility owner's inability to perform obligations to third parties, including contractual obligations; (iii) lost profits; (iv) costs of demolition or bringing the construction into compliance with the requirements (if the purchaser has performed the aforementioned actions on its own); and

- the creation of an unauthorized construction on a land plot and failure to either demolish or bring such construction into compliance with the requirements in the time stipulated in a relevant decision is added as one of the grounds for seizure of the land plot by public authorities.

5. Establishment of Procedure for Facility Demolition and Simplification of Procedure for Construction of Individual Housing Facilities

A draft law⁷ involving major changes in the Town Planning Code of the Russian Federation (TPC), including those pertaining to regulation of demolishing capital construction facilities and simplifying the approach to construction of individual housing facilities (IHF), was adopted by the State Duma in the first reading:

- the capital construction facility demolition is now defined as the liquidation of a facility by its destruction, taking apart and/or dismantling of the facility or its parts;
- the procedure of demolition is established, for example, (i) the need to prepare a demolition design plan and perform preliminary survey of a facility in certain cases, (ii) notification of a local authority of the planned demolition and the completion of demolition; and (iii) requirements to be complied with when carrying out demolition are stipulated;
- works under a demolition contract made with a developer, technical customer or a person responsible for operation of the building must be performed only by individual entrepreneurs or legal entities that are members of a self-regulatory organization in the area of construction;
- special rules of demolition of unauthorized construction are established;
- the concept of IHF has been adjusted to mean a detached residential building of not more than three stories above the ground, with a height of no more than 20 meters and not consisting of apartments or block sections (according to the TPC in effect, IHF is a residential building of not more than three stories intended for single-family residence); and
- special rules of construction supervision in respect of IHFs, as well as registration of title and cadastral registration of such facilities are established.

6. Legislative Framework for Special Investment Contracts

In autumn 2017, the Russian Ministry of Finance published a draft of the Federal Law on Special Investment Contracts,⁸ aimed at improving the current regulation of such contracts in order to increase their use and to attract investors to the Russian market. Currently, issues related to special investment contracts (SpIC) are mainly addressed by Decree of the

⁷ See Draft Law No. 302153-7 on Amendments to the Town Planning Code of the Russian Federation and Certain Legislative Acts of the Russian Federation (in respect of Simplifying the Construction of Individual Housing Facilities, Improving the Mechanism of State Construction Supervision and Facility Demolition): <http://sozd.parlament.gov.ru/bill/302153-7>.

⁸ As of the date of this Client Update, the draft law has not been introduced in the State Duma: <http://regulation.gov.ru/p/73018>.

Government of the Russian Federation No. 708 dated July 16, 2015. In particular, the draft law suggests the following:

- increasing the minimum amount of investments under a SpIC from RUB 750 million to RUB 1 billion;
- setting requirements that must be met by investors; and
- establishing the procedure for preparation, execution, performance, amendment and termination of a SpIC.

7. Preliminary Works prior to Obtaining Construction Permit

The Russian Ministry of Construction proposes to fill the existing gap in the law that generates a large number of disputes between developers/contractors and supervisory authorities concerning the possibility of performing preliminary works on a site prior to obtaining a construction permit.

The draft law⁹ stipulates that a range of works of a preliminary period of construction and reconstruction may be carried out on the basis of the developed design documentation and the permit to perform preliminary works, and the construction permit must be received within one year of the date of receipt of the permit to perform preliminary works. The Russian Government will list the types of permitted preliminary works, the terms and procedure for their performance and the requirements for persons entitled to carry out preliminary works.

COURT PRACTICE

8. Withdrawal of Consent to Sublease by Lessor¹⁰

A dispute significant for the real estate lease market concerning a possibility for a lessor to withdraw consent to a sublease of the property by a lessee has been referred by the Supreme Court of the Russian Federation to the Panel of Judges of the Supreme Court of the Russian Federation on Economic Disputes.

In considering the case of *OJSC Promsvyaz v. LLC Arenda Center* pertaining to the termination of a lease, the Supreme Court found that if consent to sublease leased property is expressly outlined in the lease, the subsequent unilateral withdrawal of such consent by the lessor constitutes a unilateral modification of the contract, which is in contravention of the

⁹ See Draft Law on Amendments to the Town Planning Code of the Russian Federation and Certain Legislative Acts of the Russian Federation (as of the date of this Client Update, the draft law has not been introduced in the State Duma): <http://regulation.gov.ru/p/73487>.

¹⁰ See Ruling of the Supreme Court of the Russian Federation No. 303-ЭС17-13540, dated November 29, 2017, in Case No. A73-5337/2016; Ruling of the Arbitrazh Court of the Far Eastern District No. Ф03-2062/2017, dated July 4, 2017, in Case No. A73-5337/2016.

civil law regulations, and, therefore, withdrawal of such consent is possible only by agreement of the parties.

The ultimate findings of the Panel of Judges of the Supreme Court on Economic Disputes will have an important impact on lease and sublease transactions going forward.

9. Termination of Sale and Purchase Agreement if Purchase Price Has Not Been Paid¹¹

The Supreme Court of the Russian Federation considered the long-standing issue of whether it is possible to terminate a sale and purchase agreement in respect of immovable property based on Article 450 of the Russian Civil Code (material breach of contract by the buyer) in the event of the buyer's failure to pay for the property in time, where title to the property has already been transferred to the buyer.

The Supreme Court noted that provisions of Article 486 of the Russian Civil Code regarding the right of the seller to demand payment for the goods and interest should the buyer fail to pay for the property does not imply that the seller is deprived of the right to terminate the contract based on the material breach of contract by the buyer.¹² The position previously widespread in court practice was that the buyer's failure to perform the obligation to pay for the sold goods only gives rise to the seller's right to demand payment for the goods and interest but not the right to terminate the sale and purchase agreement.¹³

10. Invalidation of Lease Agreement Resulting from Significant Overstatement of Foreign Currency Lease Rates¹⁴

In a case brought by *JSC Svyaznoy Logistika* (lessee) against *LLC Sklady 104* (lessor), the Supreme Court of the Russian Federation agreed with the lower courts that a long-term lease was invalid because it was made on significantly unfavorable terms.

The courts found that it was proven that the former lessee's CEO had made the agreement on apparently onerous terms for the company, that, in particular, the lease rates nominated in foreign currency had exceeded multiple times the average market rates not only at the time of making the agreement, but also over the entire period of the lease, and that the terms of sharing currency risks between the parties agreed prior to entering into the lease had not been included in the agreement.

¹¹ See Ruling of the Supreme Court of the Russian Federation No. 78-KT17-21, dated July 11, 2017.

¹² A similar position of the Supreme Court is expressed in recent Ruling No. 304-ЭС17-11435, dated November 30, 2017, in Case No. A70-9006/2016.

¹³ See, for example, Ruling of the Supreme Court of the Russian Federation No. 5-B11-27, dated June 7, 2011; Ruling of the Supreme Arbitrazh Court of the Russian Federation No. BAC-8103/10, dated July 1, 2010, in Case No. A56-18347/2009; Resolution of the Federal Arbitrazh Court of the North Caucasus District, dated March 11, 2011, in Case No. A63-3574/2010.

¹⁴ See Ruling of the Supreme Court of the Russian Federation No. 305-ЭС17-16281, dated November 3, 2017, in Case No. A41-35746/2016; Resolution of the Arbitrazh Court of the Moscow District No. Ф05-9704/2017, dated July 17, 2017, in Case No. A41-35746/2016.

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Please do not hesitate to contact us with any questions.

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