

# Top 10 Legal Developments in the Real Estate Market in 2018

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The international law firm Debevoise & Plimpton LLP presents a brief overview of the most interesting and significant developments in Russian legal regulation (including legislative initiatives) and court practice in the real estate, construction and infrastructure sectors in 2018<sup>1</sup>.

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## Legislation

### Debevoise & Plimpton

#### New Rules for Unauthorized Construction

New regulatory rules for unauthorized construction were introduced<sup>2</sup>, including the following key changes:

- **new definition of unauthorized construction:** construction is considered unauthorized only if applicable construction requirements that it does not meet (such as permitted use of the land plot, town-planning and construction parameters, obligation to obtain permits) were in force both **as of the commencement date of construction and as of the date when the unauthorized construction is revealed;**
- buildings erected with **violations of restrictions on the use of the land plot** (for example, areas with special conditions for use of the territory) can be excluded as being unauthorized buildings if **the owner of the land plot did not know and could not know about such restrictions;**

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<sup>1</sup> See the link below for a similar review of Debevoise & Plimpton LLP for 2017: <https://www.debevoise.com/insights/publications/2017/12/legal-developments-realestate-construction-2017>.

<sup>2</sup> Federal Law dated August 3, 2018, No. 339-Φ3 On Amendments to Part 1 of the Civil Code of the Russian Federation and Article 22 of the Federal Law on Enactment of Part 1 of the Civil Code of the Russian Federation.

- **the possibility of correcting building deficiencies** (instead of demolition) is fixed in order to bring it in line with the set parameters (for example, dismantling of illegally constructed floors);
- a list of properties has been introduced, the decision of the demolition of which must be made **exclusively by court**<sup>3</sup>, but not under out-of-court procedure; and
- a possible consequence of noncompliance with the decision to demolish the building or to bring it into conformity with the set parameters has been established: **the land plot**, on which such an unauthorized building is located, **can be seized from the owner** as used with a violation of Russian law<sup>4</sup>.

### Differentiation of Capital and Non-Capital Construction Facilities

An attempt has been made to resolve an issue of current interest to participants of the real estate market, *i.e.*, differentiation of capital and non-capital construction facilities. This issue, which is important for a qualifying properties as real estate, being legally unregulated, was often the subject of controversy in practice<sup>5</sup> earlier, which created significant risks for market participants (for example, property type affects the need to obtain certain permits).

The concept of a capital construction facility has been clarified—now **non-removable improvements of the land plot** (paving, surfacing, etc.) **cannot be recognized**<sup>6</sup> as capital construction facilities (and consequently, as real properties).

In addition, the concept of a **non-capital construction facility** was introduced, which has the following features:

- lack of a strong bond with the ground; and
- possibility to move, dismantle and reassemble the structure without disproportionate damage to its designated purpose and without changes in its basic characteristics.

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<sup>3</sup> For example, buildings erected on privately owned land plots; properties, the title to which is registered in the Uniform State Register of Immovable Property; former unauthorized buildings, the title to which is acknowledged by the court, etc.

<sup>4</sup> See Article 285 of the Civil Code of the Russian Federation.

<sup>5</sup> See, for example, Ruling of the Supreme Court of Russia dated September 30, 2015, No. 303-ЭС15-5520 regarding case No. А51-12453/2014. In this case, the Supreme Court of Russia pointed out that an improved site registered in the Uniform State Register of Immovable Property as an independent property, is only a paved land plot, does not bear signs of real estate and, therefore, was not subject to state registration.

<sup>6</sup> See Federal Law dated August 3, 2018, No. 342-ФЗ On Amendments to the Town-Planning Code of the Russian Federation and Separate Legislative Acts of the Russian Federation.

The changes also affect individual housing facilities. In particular, no permits are needed for development projects with the following parameters: a) not more than three floors above ground, b) not more than 20 meters in height, and c) designated purpose is for individuals' accommodation, etc.

### **Public Easements/Areas with Special Conditions on the Use of the Territory/State Construction Supervision**

The following amendments were also made to the land and town-planning legislation during 2018:

- **Public easements.** A public easement is established by the decision of the relevant authority, and an agreement is entered into by the easement holder and the rightholder of the encumbered land plot on the use of a public easement, which is subject to registration in the Uniform State Register of Immovable Property.

After the completion of activities for which the public easement was established, its holder shall bring the land plot into a suitable condition for use in accordance with the permitted use, and demolish facilities erected for executing the easement.

- **Areas with special conditions on the use of the territory.** Such areas are established by the authorized relevant authority. The establishment decision determines the legal regime, including specific restrictions on use. On land plots located within the relevant zone, the construction and use of buildings and structures, the permitted use of which does not correspond to the legal regime of this zone, is not allowed.
- Now **state construction supervision** extends to capital construction facilities that are not subject to expert evaluation. Such supervision is carried out in the form of on-site inspections, including information on violations during construction received from individuals and legal entities, as well as from the media. Following the results of the inspection, a notification on unauthorized construction may be sent to the self-governing authority.

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## Court Practice

### The Supreme Court of the Russian Federation—Changes in Types of Permitted Use of Land Plots

The Supreme Court of the Russian Federation cleared up a number of points on changes in types of permitted use (TPU)<sup>7</sup> of land plots:

- changing the TPU to another, provided by the rules of land use and development (*pravila zemlepolzovaniya i zastroyki - PZZ*), does not require any documents or approvals, except for the application for changing the TPU to be submitted to the registration authority;
- a tenant of a publicly owned land plot, rented for a particular type of use as a result of a tender, does not have the right to change the TPU of the plot, since this means avoiding the tendering procedure; and
- inconsistency of the TPU with the changed town-planning regulations is not an obstacle for further use of the land plot and capital construction facilities on it, unless such use is dangerous to human life and health, environment, etc.

### Consequences of Termination of the Contract for Guarantee Retention

The Supreme Court of the Russian Federation<sup>8</sup> made the following conclusions on the consequences for guarantee retention upon termination of the construction contract:

- client's unilateral repudiation of the contract caused by the actions (omission) of the contractor does not constitute a ground for the early repayment of the guarantee retention to the contractor;
- initiation of bankruptcy proceedings in relation to the contractor is not a ground for the early payment for the entire scope of work performed (repayment of the guarantee retention amount); and
- from the date of the early termination of the contract, the implication of the clause of the contract regarding repayment of the guarantee retention amount upon the expiration of a certain period after the commissioning fully depends on the client; subsequently, if the client has unfairly prevented the commissioning, at the request

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<sup>7</sup> See Review of practice in proceedings related to changes in types of permitted use of a land plot approved by the Presidium of the Supreme Court of the Russian Federation on November 14, 2018.

<sup>8</sup> See Ruling of the Supreme Court of Russia dated March 12, 2018, No. 305-ЭС17-17564 regarding case No. A40-67546/2016.

of the other party, this circumstance can be considered as having occurred in order to start the guarantee period (Article 157 of the Civil Code of the Russian Federation).

### **Joint Responsibility of the Client and the General Contractor**

The Supreme Court of the Russian Federation<sup>9</sup> reviewed an important case on the responsibility of the general contractor towards the subcontractor for late payment for the work performed.

Under the terms of the subcontract, as well as a tripartite agreement between the client, the general contractor and the subcontractor, payment for the work performed by the subcontractor is made directly by the client, bypassing the general contractor. The Supreme Court noted that, despite the specified clause, the general contractor, together with the client, is responsible to the subcontractor.

The Supreme Court stated that the client can not be solely responsible to the subcontractor since the latter did not give consent for replacement of the general contractor by the client as the debtor.

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## **Draft Bills**

### **Reform of Special Investment Contracts (SPICs)**

SPICs, which is a way to support investment in the industry, appeared in 2015. Since then, they have been particularly widespread in the automotive industry because they have replaced industrial assembly agreements. The decision to reform SPICs was taken, among other things, in order to increase incentives for investors as well as to expand the scope of SPICs.

Currently, the final decision on the future of SPICs has not been made. The Ministry of Industry and Trade and the Ministry of Finance are simultaneously developing two draft bills, the first of which provides for the concept of new SPICs (SPIC 2.0)<sup>10</sup>, and the second one – a mechanism of investment promotion and protection agreements (IPPA)s<sup>11</sup>.

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<sup>9</sup> See Ruling of the Supreme Court of Russia dated April 17, 2018, regarding case No. 307-ЭС17-19861, А56-40013/2016.

<sup>10</sup> The project has not yet been submitted to the State Duma of the Russian Federation. See <http://regulation.gov.ru/p/82853>.

<sup>11</sup> The project has not yet been submitted to the State Duma of the Russian Federation. See <http://regulation.gov.ru/p/85307>.

Within the SPIC 2.0 concept, it is planned to completely change the purpose of SPICs and make them a tool for the development of manufacture of products that will be competitive in the global market or have no analogues in Russia.

It is also proposed to increase the term of SPICs (15 and 20 years depending on the investment amount vs 10 years for current SPICs) to allow co-investment (currently, only one investor can participate). The draft also provides for a number of tax guarantees: non-worsening of the position of the investor-taxpayer regarding all taxes, except for VAT and excise taxes; and abolition of the current restriction on which income tax exemption is granted until 2025. It is supposed that there is a stabilization clause – regulatory acts imposing restrictions and prohibitions on the realization of the investor's rights under the SPIC will not be applied.

IPPAs, in turn, are meant for a wider scope of application and can be used to implement projects in agriculture, mining, construction, etc. The term of IPPA is shorter than that of SPIC (6 or 12 years depending on the investment amount), while a number of guarantees are provided for the stability of the investor's activities (including tax guarantees).

Both SPIC 2.0 and IPPA provide for an opportunity for the investor to receive compensation (for example, tax preferences) if the state fails to provide the stability of the investor's activities under the relevant agreement (SPIC or IPPA).

At the same time, it is not yet determined how the two state support measures will be applied: will they complement each other, or will only one support measure be chosen.

### **Abolition of the Need to Provide a Technical Plan when Registering the Lease of Part of Property**

A draft bill<sup>12</sup> was submitted to the State Duma of the Russian Federation, which greatly simplifies the procedure for registering a lease agreement for a part of a building or structure. As part of the registration process, cadastral registration of the relevant part is carried out, and in accordance with the established practice of the registering authorities, the parties to the lease agreement shall provide the technical plan of the part of the building or structure for registering purposes. The draft proposes to directly specify in the law that the provision of a technical plan is not required if the registering authority already has it.

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<sup>12</sup> See Draft Bill No. 601596-7. See the link below for the status of the bill: <http://sozd.duma.gov.ru/bill/601596-7>.

## Abolition of Land Categories

The draft bill<sup>13</sup>, developed by the Ministry of Economic Development of the Russian Federation, proposes to abolish the existing division of land into seven categories and replace it by dividing it into 18 areas. The bill provides for a corresponding TPU for each area. The land plot can be located within only one area.

The proposed land division provides for greater flexibility in comparison with the current regime. In particular, if the bill is adopted, the complicated procedure for transferring land from one category to another will also disappear along with the land categories. It will be enough for the party concerned to choose the required TPU from among those envisaged for this area.

## Work on Amendments to the Civil Code of the Russian Federation in the Real Right Section

On April 27, 2012, the State Duma of the Russian Federation adopted in the first reading a bill containing, among other things, amendments to the section on real rights.

It is planned to continue working on draft amendments. Let us recall that the draft proposes to introduce certain provisions regarding possession: the concept, objects of possession, ways of acquiring possession, and unified rules for the protection of possession. It is proposed that limited proprietary rights, in addition to the building leasehold, shall include the right of permanent land tenure, the right of personal use, the right to acquire someone else's real thing, the right of limited ownership of a land plot, etc.

*(See Draft Bill No. 47538-6 On Amendments to Parts One, Two, Three and Four of the Civil Code of the Russian Federation and to Separate Legislative Acts of the Russian Federation).*

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We will be happy to discuss any questions you may have on this subject.

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<sup>13</sup> The project has not yet been submitted to the State Duma of the Russian Federation. See <http://regulation.gov.ru/p/85531>.