

9. PROPERTY RIGHTS

9.1 Introduction

Both the *Constitution of the Russian Federation* and the *Civil Code of the Russian Federation* uphold the right to own private property. The *Land Code* of October 2001 and other legislation adopted in development of the *Land Code's* provisions implement this principle further.

The *Land Code*, together with Federal Law No. 101-FZ *On Circulation of Agricultural Land* of 24 July 2002 as amended (the *Agricultural Land Law*), which entered into force in January 2003, put an end to the political debate as to whether land ownership in Russia is possible. Federal Law No. 172-FZ *On Reclassification of Land and Land Plots from One Category to Another* of 28 December 2004 as amended (the *Land Reclassification Law*), came into force on 5 January 2005. Being a follow-up on the *Land Code*, it detailed the procedures for the reclassification of land and land plots from one category to another. The *Land Reclassification Law* defines the respective powers of federal authorities, authorities of the constituent entities of the Russian Federation (see p. 1.3), and local authorities in the procedure of changing the category of land plots. The uniform mechanism instituted at the federal level to move land plots from one category to another marks a significant development in making the land market in Russia more transparent.

Owing to some historical aspects such as the fact that transactions with real properties (other than land plots) became possible earlier than the transactions with land plots, at present Russian law still treats land plots and buildings as separate objects of real estate. Despite this, however, there is a concept of a single object of real estate embodied through provisions which prohibit the disposal of a land plot and a building located on such land plot separately from each other in the circumstances where such properties are owned by one and the same owner. In circumstances where a building is located on a land plot which is state or municipality owned and unless there are other buildings or structures on the land plot owned by third parties, the owner of such building has an exclusive right to lease such land plot or acquire it into ownership.

Under Russian law, the most common types of rights to real estate available for investors are the right of ownership and leasehold. However, there are, for the moment, different regulations with regard to land plots and buildings.

Land

The *Land Code* distinguishes the following rights to land: the right of ownership (by the Russian Federation, constituent entities of the Russian Federation, municipalities, private individuals, and legal entities), the right of perpetual (indefinite) use, the right of free fixed-term use, leasehold, the right of lifelong inheritable possession, and easements (servitudes). Land plots are generally available for investors under the right of ownership and lease.

Right of Ownership

The general principles of land ownership are set forth in the *Constitution of the Russian Federation*, adopted in December 1993. The *Constitution* establishes the principle of private ownership of land but does not regulate land relations in detail. The core legislative act governing land relations is the *Land Code*, which establishes fundamental terms and procedures for the land use. It is further supplemented by other federal laws regulating land issues, often referred to in the *Land Code*. For instance, it has limited applicability to agricultural land, as it expressly provides that the circulation of such land is also the subject of a separate law, the *Agricultural Land Law*. The *Land Code* is also supplemented by regional laws and other regulations, which the constituent entities of the federation may issue in compliance with the *Land Code*. In the case of disagreement between such laws and the *Land Code*, the latter enjoys preferential status.

The possession, use, and disposal of land plots attributable to the category of agricultural land are regulated by the *Agricultural Land Law*. Not all agricultural land, however, is subject to the *Agricultural Land Law*. It does not extend, for example, to those land plots that were provided to individuals for the construction of individual homes or garages, or for a smallholding or dacha garden, and land plots underlying buildings and other structures; the circulation of such land plots is governed by the provisions of the *Land Code*. Agricultural land plots may be held by right of ownership, perpetual (indefinite) use, lifelong inheritable possession, or free fixed-term use, and such plots may also be leased.

Ownership of land plots in state or municipal ownership, where such land plots are free from any buildings and structures, is to be awarded (for the purposes other than development and construction to which special rules apply) to individuals and legal entities, as a rule, through bidding by tender or auction. Such bidding may also be held for granting the lease of a land plot when it is claimed by two or more potential lessees - the organization of such tenders or auctions is detailed in Article 38 of the *Land Code*.

Although there is no express provision permitting land ownership by foreigners (including stateless persons), the *Land Code* may clearly be interpreted as allowing such ownership, except in cases where it is specifically prohibited. The rights to acquire land plots under existing buildings, or for construction, into lease or ownership are equally vested to foreigners, subject to the following restrictions set out in the *Land Code*:

- Foreigners are specifically prohibited to own land plots in border areas (a list of which is to be drawn up by the President), or in other special territories of the Russian Federation pursuant to other federal laws. Additionally, the President may establish a list of types of buildings and other structures to which pre-emptive buy-out or lease rights to land plots for foreigners may not apply. Under the *Implementing Law* and pending the preparation of the Presidential list, the border restrictions apply to all border areas.
- Foreigners are prohibited to own agricultural land. The *Agricultural Land Law* further specifies the rights to agricultural land that may be granted to foreign nationals and foreign legal entities (and stateless persons): those in this category may only lease agricultural land plots. This restriction on foreign legal entities also extends to Russian legal entities in which the equity participation of foreign nationals, foreign legal entities, and/or stateless persons exceeds 50%.
- Foreigners are prohibited to own land plots located within the boundaries of sea ports.

Lease

Foreign legal entities and individuals may be granted leases to land plots. Such leases for state or municipally owned property are usually based on a standard local form. Although neither the *Civil Code* nor the *Land Code* stipulate a statutory maximum length of land lease, the lease term in most cases does not exceed 49 years.

For instance, In Moscow, Moscow City Law No. 48 *On Land Use in the City of Moscow* of 19 December 2007, which came into force on 5 January 2008, sets different periods for which leases of Moscow-owned land plots may be obtained. The lease terms for sites free of any buildings, structures, or facilities may not exceed five years. Land plots on which such property is located are, however, available for 25-49 years of lease. This term can be reduced upon the parties' consent.

The level of rent payments for the majority of land leases granted by the state or municipalities is set by a general local decree. In Moscow a lessee must pay for the right to lease any land in excess of the area of the existing buildings on that land. In St. Petersburg, the level of rent is determined by the city law No. 608-119 “On the Method for Determination of Rental Payments for Land Plots Owned by St Petersburg” of 5 December 2007 (the law came into effect on 1 April 2008). If the right of ownership to a land plot has not been delimited, the level of rental payments with regard to such land plot is established by a resolution of St Petersburg government. In both cases the lease rates vary depending on the location of the site, the type of activity of the lessee etc.

The *Land Code* provides a lessee with certain basic rights. A lessee that properly fulfills its obligations under a lease has a pre-emptive right of lease renewal at the end of the lease term. The renewal rights of a lessee under a land lease are to be treated in conjunction with the pre-emptive right to purchase the land granted to the lessee (where the land in lease is state or municipally owned) and the exclusive right of the owners of the existing buildings and structures to purchase or lease the underlying land plot.

Significantly, the provisions of the *Civil Code*, in so far as they apply to land leases, are supplemented by the *Land Code* in a number of areas. In particular, the *Land Code* sets forth a series of modified rights for land lessees. Their applicability will in part depend upon the precise drafting of a lease. For example, the presumption under Article 615 of the *Civil Code* that a lessee needs a lessor’s consent to sublease has been reversed for lessees of land. Of particular significance is the provision that lessees of state or municipally owned land under a lease exceeding five years term are free to assign their rights under the lease, to mortgage such rights or grant the land plots for sublease to third parties, subject only to giving notice to the lessor. This rule will also apply to land leases for a period of more than 5 years with private lessors (in contrast to the prior consent requirement established under Article 615(2) of the *Civil Code*). The assignee of a land lease does not need to enter into a new land lease.

The lessor and the lessee may terminate the lease contract (1) upon mutual agreement, (2) unilaterally in circumstances stipulated in the lease, (3) by a court order in circumstances provided by the *Civil Code* or the *Land Code* or in the lease. The *Land Code* contains provisions that deal with the termination of land leases in conjunction with a court order. For example, the following will constitute grounds for termination of a land lease:

- Misuse of the land plot (a more stringent test than that under Article 619 of the *Civil Code*, which requires either substantial or repeated violations);
- Use of the land plot that results in a decline in the fertility of agricultural land or, importantly for industrial users, a material deterioration in the environmental situation;
- Failure to correct a range of other intentional environmental violations of applicable land use regulations; and
- Where the designated purpose of the land plot is agricultural production or development - failure to use the land plot for its designated purpose for a period in excess of three years.

Other Rights to Land

The right of perpetual (indefinite) use may be granted only to state and municipal institutions, federal treasury-owned enterprises, and state and local authorities. Legal entities which possessed land plots on the right of perpetual (indefinite) use before the introduction of the *Land Code* and which do not fall under the above categories of legal entities had to convert and re-register this right at their choice either into lease or ownership until 1 January 2004. This deadline has been extended several times and is currently established as 1 January 2010 as a general rule and as 1 January 2013 with regard to land plots under transportation, communications and utilities lines⁶⁵. Failure to convert the rights by the established deadlines will trigger an administrative penalty of 20,000 - 100,000 rubles (approximately USD 580 - 2,900 as at February 2009). However, the penalty is established with effect from 1 January 2011. As the civil circulation of land plots held on the right of perpetual (indefinite) use is restricted, *e.g.*, such land plots cannot be sold, leased, mortgaged, or assigned, the disposal of such land plots by legal entities (which do not fall under the above categories) will always require a prior conversion of the right of perpetual (indefinite) use into another title (*e.g.*, for commercial legal entities - into lease or ownership).

⁶⁵ It is currently considered to further extend these deadlines to 1 January 2013 and 1 January 2016 respectively.

Acquisition of Rights to Land Plots for Construction Purposes (Other Than Residential Construction)

The *Land Code* sets out detailed procedures for acquiring rights over state or municipally owned land plots for the purpose of new non-residential construction. The *Land Code* distinguishes two kinds of procedure: (1) without preliminary approval of the location of facilities, and (2) with such preliminary approval.

The granting of land plots without preliminary approval of the location of facilities is carried out through bidding by tender or auction (Article 38 of the *Land Code*).

A land plot which is granted for construction purposes in accordance with the procedure where no preliminary approval of the location of facilities is required must satisfy the following criteria: (1) its boundaries must have been defined for the plot to be eligible for sale or lease, (2) a cadastral number (indicating the area, location, category, and other essential characteristics of the plot) must have been assigned, (3) a designated use of the land plot must have been properly defined, and (4) technical conditions for the connection to utilities must have been determined.

The granting of land plots with preliminary approval of the location of facilities is applied when a land plot meeting the requirements of a particular project does not exist or a new construction project requires a thorough investigation of ecological, sanitary, architectural and other issues, and upon a specific request for granting a land plot for construction from an investor. This may also involve the investigation of public opinion regarding the planned construction. In accordance with this procedure a land plot initially is granted to legal entities and individuals into lease only. This, however, does not preclude the owner of the facilities (upon their completion and state registration) from acquiring the underlying land plot into ownership. With regard to construction of facilities of religious function, religious organizations are granted the right of free fixed-term use for the period of such construction. In this case, land plots are granted without holding an auction.

The preliminary approval of the location of facilities is not required with regard to land plots in urban areas if town-planning documentation and zoning plans have been approved for such land plots. Such land plots must be granted through an auction.

Exclusive Right

As mentioned in Section 9.1 above, the owners of buildings and structures which are located on land plots owned by the state or by a municipality are vested an exclusive right to acquire the underlying land plots either into ownership or lease (Article 36 of the *Land Code*). With regard to facilities erected on such land plots after the *Land Code* had become effective this rule signifies that an owner of the facility, upon registration of title (see p. 9.4), may opt either for the extension of the lease, the extension of the lease and subsequent acquisition into ownership, or immediate acquisition into ownership. Availability of a valid lease contract does not preclude the owner of the facilities from acquiring the underlying land plot into ownership before the expiry of the lease. The *Land Code* does not establish a deadline by which the owners of the facilities should exercise their right. With regard to facilities erected before the entry of the *Land Code* into effect the rule is generally the same, although in circumstances where the underlying land plots had been granted on the right of perpetual (indefinite) use, then in accordance with the Federal Law No. 137-FZ *On the Entry into Effect of the Land Code of the Russian Federation* of 25 October 2001 (the *Land Code Enforcement Law*) the owners of facilities located on such land plots must acquire such land plots into ownership or lease until 1 January 2010 (in case of land plots under transportation, communications and utilities line - until 1 January 2013)⁶⁶.

9.3 Other Real Estate

Ownership

Russian legislation permits both Russian and foreign nationals and legal entities to own real estate (apart from land plots) such as buildings, premises (as parts of buildings), structures and other facilities. In general, the rules relating to the use, disposal, and sale of real estate are set forth in the *Civil Code*, which guarantees the freedom to sell, rent, and carry out other transactions with real estate. Title to real estate is usually acquired through a sale-purchase transaction or by means of new construction. For legal entities which were formed in the course of privatization of Soviet era enterprises it is usual that title to buildings and structures had been obtained as a result of such privatization.

⁶⁶ It is currently considered to further extend these deadlines to 1 January 2013 and 1 January 2016 respectively.

In accordance with the *Civil Code*, title (and other rights) to real estate arises after its state registration, which is governed by Federal Law No. 122-FZ *On State Registration of Rights to Real Estate and Transactions Therewith* of 21 July 1997, as amended (the *Registration Law*). Upon request of a legitimate acquirer of title (*e.g.*, buyer under a sale-purchase agreement), the authority in charge of the state registration of rights to real estate must state register the title and issue an ownership certificate evidencing the registration of title (see Section 9.4 below).

For all owners of real estate, the ownership right has to be state registered in accordance with the procedure set forth by the *Registration Law*. The exceptions to this rule relate to rights to real estate which had been acquired prior to the adoption of the *Registration Law*. The owner of such real estate is not obligated to state register its rights unless it wishes to enter into any transaction involving its real estate (*e.g.*, lease, mortgage, sale).

Obtaining an ownership certificate is a fairly straightforward, although sometimes lengthy, process, as long as the private company seeking to obtain such certificate can clearly demonstrate that real estate in question was purchased, constructed, or privatized in accordance with the established procedures. Before an ownership certificate is issued a cadastral documentation must be obtained on such real estate.

Title to real estate acquired through privatization sometimes cannot be registered as a result of deficiencies in privatization documentation. In the past, state-owned real properties were granted to state-owned enterprises for economic management or use. During privatization process of the early 1990s such real properties were usually transferred into the ownership of those enterprises which were formed on the basis of Soviet state-owned enterprises which operated and used such real properties on the basis of various “usage”-type rights. A newly privatized enterprise thus “inherited” such real properties from the state-owned enterprise, provided that the real properties as recorded on the balance sheet of the state-owned enterprise were easily tracked out in a privatization plan of a newly formed (privatized) enterprise. The problem of title registration is not unusual for legal entities which are the legal successors of such Soviet era state-owned enterprises. Such legal entities may, however, register title by virtue of acquisitive prescription (15 years) on the basis of court order.

Lease

Foreign legal entities and individuals may be granted leases to other real properties (apart from land plots). Alike with leases of state or municipality owned land plots, leases of other real properties in state or municipal ownership are usually based on a standard local form.

The *Civil Code* provides a lessee with certain basic rights. When the property is granted into lease, it must be in the condition stipulated by the lease. Thereafter, unless the lease specifies otherwise, the lessor is liable for the repair of defects of the premises. If the lessor fails to carry out the necessary repairs, the lessee can opt either for the reduction of rent or termination of lease and compensation of losses incurred. A lessee that properly fulfills its obligations under the lease has a pre-emptive right to renew the lease (i.e., enter into a new lease for the same premises and not necessarily on the terms of the preceding lease) unless this right is expressly excluded by the lease contract.

The lease survives the change of ownership over the leased property. The lease of buildings and structures assumes the right to use (either in lease or under another right of usage) the land plot which underlies such buildings and structures and which is necessary for their operation and use. Similar to the lease of land plots, the lessor and the lessee may terminate the lease (1) upon mutual agreement, (2) unilaterally in circumstances stipulated in the lease, (3) by a court order in circumstances provided by the *Civil Code* or in the lease.

Leases for one year and longer must be state-registered and are deemed concluded upon such state registration. Leases for less than a year (any 365 consecutive days) do not require state registration and become valid when signed. To avoid the obligation of state registration, which can be a time consuming process, leases are often concluded for less than a year and renewed on a regular basis. If the procedure is properly described in the lease, such renewal of the lease is regarded as conclusion of a new lease for a period of less than a year.

9.4 State Registration of Rights to Real Estate

The right of ownership and other proprietary interest to real properties, their creation, encumbrance (e.g., mortgage, leasehold for a term of one year and longer, easement), transfer and termination are subject to state registration. In the absence of state registration, the rights to real estate are invalid. The *Registration Law*

stipulates procedures for the identification and registration of rights to real estate. In many cases, registration of title is a prerequisite for the validity and enforceability of transactions involving real estate.

Certain transactions (in addition to the *rights* or *titles*) with real estate are also subject to state registration, and become effective only upon such registration. The registration process is carried out by the registration authorities at the location of the real estate in question. Under the *Registration Law*, state registration of a right to an object of real estate and/or registration of a transaction with an object of real estate takes one month, although in practice this term may be significantly extended as a result of suspension or refusal of registration. In certain cases, however, state registration of rights and transactions takes less than one month. The grounds for suspension or refusal of registration of rights/transactions are specified in the *Registration Law*. Refusal of state registration can be contested in court.

The registration authorities maintain the Unified State Register of Rights to Real Estate and Transactions Therewith (the “Register”), which indicates the history and the current legal status of a real estate object. The Register also records various “registerable” encumbrances over real estate (including long term leases and easements) and restrictions (such as freezing orders against, or court disputes relating to, the real state object). The registration authority issues a certificate in a statutorily defined form that certifies on which right an object of real property is held by a legal entity or individual and which encumbrances and restrictions, if any, are established with regard to such object. Information on state-registered transactions with immovable property is also included in the Register. Basic information on the right holder(s) and restrictions (encumbrances) of such rights is open to the public, and can be provided for a fee to any person submitting a written request within five business days after submission of an application to the registration authority.

Land plots are also required to undergo cadastral registration. The procedures and rules for the state cadastral registration of land are outlined in Federal Law No. 221- FZ *On State Cadastre of Immovable Property* of 24 July 2007 (the *Cadastre Law*) upon the enactment of which on 1 March 2008 *Law on the State Cadastre* of 2 January 2000 ceased to have effect. Under the *Land Code*, only land plots that have been subject to state cadastral registration can be the objects of sale-purchase transactions. Particularly in Moscow, this applies to all transactions with land plots. The State Cadastre is established pursuant to the *Cadastre Law* and contains detailed

information on all objects of real properties including land plots, buildings, structures, premises and other facilities. Information contained in the State Cadastre is available to the public.

As a single source of information on real estate available in electronic format the State Cadastre will become operational from 1 January 2012. Transition rules apply until 1 January 2010. The *Cadastre Law* provides for a unified system of state cadastre registration of all basic types of real estate, including land plots, buildings, premises, unfinished construction, complex immovable property objects, territorial and functional zones and zones with usage conditions.

With effect from 1 March 2009 the government agency which performs state registration of rights to real properties (formerly named as Federal Registration Service) has been renamed into Federal Service on State Registration, Cadastre and Cartography and became responsible also for cadastre registration of real estate (including land plots).

The *Cadastre Law* does not apply to forests, perennial plantations, bodies of water, subsoil resources, marine vessels and aircraft.

9.5 Classifications of Real Estate

There is no official legislative classification of real estate (properties) in Russian law. In practice, real properties are classified on the basis of their intended use (*e.g.*, residential or non-residential for buildings, agricultural or industrial for land plots, etc). The designated use should be identified in the lease, the certificate of ownership, as well as in the BTI technical documentation and cadastral documents.

Building, structures and other facilities require various obligatory state permits and approvals. The *Town Planning Code* of 29 December 2004, as amended (the *Town Planning Code*), stipulates documents and procedures to be obtained / followed for the purpose of carrying out construction. Construction activities are also governed by regional and municipal legislation, such as, for instance, the Town Planning Code of the city of Moscow, adopted by Moscow City Law No. 28 of 25 June 2008, which came into effect on 10 July 2008.

9.6 Payments for Real Properties

Historically, when a foreign investor acting through a non-Russian entity purchased or leased real estate from Russian residents, payments effected under such transactions (in foreign currency) were classified as “capital transfer transactions”, requiring a specific license from the Central Bank of the Russian Federation.

This licensing requirement had been abolished and under Federal Law No. 173-FZ *On Currency Regulation and Currency Control* dated 10 December 2003 (the greater part of which came into effect on 17 June 2004), foreign currency payments made by foreign investors to Russian residents in consideration for purchased or leased real estate are no longer regarded as “capital transfer transactions”. Payments between Russian residents can be carried out in rubles only. Where a seller or a buyer, or both the seller and the buyer (or the lessor and the lessee) are foreign legal entities, settlements are possible in foreign currency. Settlements between foreign residents (including legal entities and individuals) can be carried out through foreign (non-Russian) bank accounts. However, transactions with real properties may trigger Russian tax consequences even if carried out outside Russia.

9.7 Residential Real Estate

Until the early 1990s, most apartments in the Russian Federation were state or municipally owned. However, many (if not most) apartments have since been privatized and many new residential developments have been constructed by investors, and most of these apartments are in private ownership. Relations arising in connection with residential real estate are regulated by the *Housing Code* of 29 December 2004 (the *Housing Code*), which came into effect on 1 March 2005. The *Housing Code* defines categories of residential property, which include a residential house (cottage), an apartment in a multi-storey (multi-apartment) building or a room in such an apartment, as well as various forms of rights to residential real estate. The *Housing Code* prohibits the use of residential property for purposes other than residence by individuals.

9.8 Mortgage of Real Properties

General

Mortgage arises either by virtue of law or the mortgage agreement. Mortgage rights must be state registered and are invalid without such registration. Registration is mandatory and in its absence a mortgage agreement is null and void.

Federal Law No. 102-FZ *On Mortgage of Real Property* of 16 July 1998 (the *Mortgage Law*) stipulates the following essential terms of a mortgage agreement: (1) description of the mortgaged property (described to the extent sufficient to identify it), its location, and valuation; (2) nature, scope and maturity date of an obligation secured by mortgage; (3) the right on which the mortgaged property is held by the mortgagor; and (4) name of the registration authority that registers the mortgage. Per request and subject to the payment of state duty, local offices of the state registration authority (from 1 March 2009 - Federal Service on State Registration, Cadastre and Cartography) can provide information on whether a specified object of real properties is mortgaged. Such information is provided in the form of an extract from the Register.

According to the *Mortgage Law*, the following types of real properties can be subject to a mortgage:

- Land plots (including agricultural land plots), with the exception of land plots which have been withdrawn from or are limited in circulation, and the land plots held by state or municipalities;
- Enterprises registered as real estate;
- Buildings, structures, and other immovable property that are used for business activities;
- Residential houses, apartments and parts thereof, consisting of one or several separate rooms;
- Cottages, garages, and other structures for personal use;
- Aircraft, sea and river vessels; and
- A lessee's interest in leased real properties, which may be the subject of a "leasehold mortgage".

Buildings and structures can only be mortgaged together with the land plots, or together with leasehold rights to such land plots, on which such buildings and structures are located.

The existing mortgage of a land plot is automatically extended to cover a building or structure erected on such land plot by the mortgagor, unless otherwise provided by the mortgage agreement. This provision of the *Mortgage Law* allows a mortgagee to

extend the mortgage over a land plot to all buildings and structures that may be constructed on the plot, without the need for a subsequent addendum to the mortgage agreement.

The terms and conditions of a mortgage may restrict the owner's or user's capability to dispose of the property, including its contribution to charter capital and/or lease to third parties. The disposal of mortgaged property generally requires a mortgagee's consent unless the mortgage agreement provides otherwise. Notwithstanding such consent, the mortgage survives the change of ownership over the mortgaged property, or the change of holder of such property, unless and until the primary obligation secured by the mortgage is performed and the property is released from it. The release of property from mortgage is also subject to state registration.

The *Mortgage Law* provides that, unless otherwise provided in the mortgage agreement or by federal law, a residential house or an apartment that was purchased or constructed with loans from banks or other credit companies is deemed to be mortgaged from the date of state registration of the ownership right of the purchaser/investor of the house or the apartment. The *Mortgage Law* further provides that foreclosure by the mortgagee on a mortgaged residential house or apartment and disposal of such property constitutes grounds for termination of the occupancy rights of a mortgagor and the family members residing together in such residential house or apartment, provided that this residential house or apartment was mortgaged under a mortgage agreement to secure the return of a loan granted for the purchase or construction of such residential house or apartment, or a loan granted to refinance the previous construction / acquisition loan.

The implications of these provisions of the *Mortgage Law* are that a mortgagee can now demand that a mortgagor vacates the mortgaged property if the mortgagee intends to foreclose on it. However, this rule would apply only if the mortgaged property were mortgaged to secure the repayment of a loan taken by a mortgagor to purchase or construct a property or to refinance such previous construction / acquisition loan. It is also important to note that those individuals who occupy mortgaged property pursuant to a lease or a "hiring" agreement (under Russian law, a specific type of residential lease where the lessee is a private individual) cannot be evicted upon foreclosure on the mortgaged property. Such a lease or a "hiring" agreement concluded prior to the mortgage agreement will remain in force and can be terminated only under specific circumstances provided for by the *Civil Code* or applicable housing legislation.

Amendments Introduced with Effect from January 2009

The *Mortgage Law* has been significantly modified to improve the potential of mortgages as an instrument for securing investments by the two federal laws which were adopted in December 2008 - Federal Law No. 264-FZ of 22 December 2008 and Federal Law No. 306-FZ of 30 December 2008. The laws came into effect on 26 January 2009 and 11 January 2009, respectively. Key amendments are as follows.

Foreclosure on the mortgaged property. There are two types of foreclosure on mortgaged property: court and out-of-court. With regard to an out-of-court foreclosure, before the amendments, the parties could enter into a contract for the transfer of the mortgaged property to the mortgagee to discharge the secured obligation only after an event of default under the secured obligation has occurred. In the absence of such contract, a mortgagee cannot automatically acquire rights to the mortgaged property if an event of default occurs, and in most cases the mortgaged property must be sold at a public auction, with the proceeds then being used for repayment of the debt.

Now, the transfer of the mortgaged property to the mortgagee after an event of default has occurred is possible if the parties stipulate so in the mortgage agreement or in a separate agreement, provided that a notarized consent of the mortgagor to such an out-of-court foreclosure on the mortgaged property has been obtained. In an agreement on out-of-court foreclosure the parties are required to stipulate, among other things, the method of an out-of-court foreclosure (i.e., realization of the mortgaged property at an auction or the acquisition of ownership of mortgaged property by the mortgagee for itself or for third parties), initial sales price of the property or the procedure for the sale price determination.

Out-of-court foreclosure on mortgaged property is prohibited with regard to residential properties held by individuals under the right of ownership and with regard to real properties owned by the state and municipalities.

Mortgage certificates. Mortgage certificate can be issued to the mortgagee at any time after the state registration of the mortgage and until the termination of secured obligation. Mortgage certificates can be transferred to depositary for registration and custody, which is evidenced by respective note on the document. Such note should also disclose if the custody is temporary or obligatory. The type of custody can be chosen by the issuer or by a subsequent holder of the mortgage certificate.

Mortgage agreement vs mortgage certificate. If a mortgage agreement, on the basis of which a mortgage certificate is issued, stipulates that with the issuance of the mortgage certificate both the mortgage agreement and the principal agreement (obligations under which are secured by the mortgage) terminate, all relations between the mortgagor, the debtor, and the mortgagee become governed by the mortgage certificate.

10. PRIVATIZATION

10.1 History of Privatization

In general, the privatization process in Russia can be roughly summarized as occurring in three progressive stages. The first stage of “voucher-assisted privatization” lasted from 1992 to 1994, and included the privatization of state property on a massive scale. This first privatization scheme allocated vouchers to state employees, with these vouchers later transformed into shares in the capital structures of newly established (privatized) joint stock companies.

Although at this early stage the country lacked experience in all privatization matters, and the first *Privatization Law* of 3 July 1991 was perhaps inevitably undeveloped, the Government’s rush to privatize companies through the allocation of vouchers resulted in a very large percentage of state-owned entities being transferred into private hands.

The second stage of the privatization process lasted from 1995 to 1996, and was focused on obtaining large payments for significant enterprise stakes. The principal objective of this scheme was to replenish the state budget and to attract domestic and foreign investment into Russia. Unfortunately, this objective was never achieved because:

- Most of the financially viable and attractive businesses had already been privatized during the first stage of development;
- Domestically, large-scale investors did not yet exist; and
- Foreign investors were still wary of large-scale capital injections into Russian entities (particularly due to the volatile political environment in the Russian Federation at the time).