

Informative Memorandum

AMENDMENT OF PART ONE
OF THE RF CIVIL CODE

1 February 2013

On December 2012, the RF President signed Federal Law on Amendment of Chapters 1, 2, 3 and 4 of Part One of the RF Civil Code, (the “Law”) adopted by the State Duma on December 18, 2012 and approved by the Council of Federation on December 26, 2012. The Law purports to improve and modernize the rules of Russian civil laws and regulations. The major part of the changes will come into force on March 1, 2013.

Below are the key changes introduced in the RF Civil Code (the “CC”) by the Law.

Fundamentals of Civil Law

The Law secures **the principle of good faith** in the exercise of civil rights and performance of obligations. That principle corresponds to the ideas of the modern civil law doctrine and was long ago introduced into the laws of the majority of countries with a developed rule of law. The introduction of that principle in the Law would make it possible for parties in civil commerce to seek civil-law remedies more successfully in the event of bad-faith actions of their counterparts¹.

The Law replaces the term “business custom” with a broader term “custom”: “custom is the rule of behavior established and widely used in some area of business or other activity, not stipulated by law, irrespective of whether or not it is fixed in any document”. Thus, the term “custom” is not limited to business customs and the area of activity where it was established and is used. That change reflects the practical use of such rules of behavior, including spheres other than business activity.

¹ Courts applied the principle of good faith in the consideration of cases before. See Informative Letter of the RF SAC Presidium, dated September 13, 2011, No. 147; Rulings of the RF SAC Presidium on the important issues of civil law (on the basis of the publications on the SAC site in May 2012).

New Article 8.1 regulates the fundamentals of civil-law aspects connected with rights to property, including real estate. The Article secures the grounds and the procedure for recording rights subject to state registration in the Consolidated State Register of Legal Entities, and establishes basic requirements to state registration of rights to property.

Rights to property subject to state registration arise, are changed and cease to exist as of the time a corresponding record is made in the State Register, unless the law sets forth otherwise. A transaction involving rights to property, being subject to state registration, should only be certified by a notary public in cases stipulated by the law or the parties' agreement. The Law revokes the currently effective provision on registration of certain agreements with respect to real estate. Starting from March 1, 2013, not subject to state registration will be agreements for sale of a house, apartment, part of the house or apartment; sale of enterprise; gift of real estate; annuity with respect to real estate; rent of real estate executed for a term of over one year; and rent of an enterprise. This change is aimed at abolishing the institute of the so-called double registration.

However, the novel gives rise to a number of questions. First of all, **abolishment of registration of an agreement for lease** of real estate and lack of regulation of the lease right registration: when abolishing registration of a lease agreement the legislator did not take into consideration the currently effective rules on registration of lease right which is effected by registration of a lease agreement. This situation evokes numerable questions of legal and practical nature. For example, when executing an agreement with respect to real estate after March 1, 2013, the purchaser would not be able to make sure that the real estate in question is not encumbered by lease, because the purchaser would have no instrument for making a check. Thus a real threat of multiple lease of the same real estate and an uncertainty as to the previously registered lease agreements. In particular, there remains the unresolved issue of whether it is necessary to apply to a

registering authority for formalization of early termination of a lease agreement executed before March 1, 2013 or whether state registration is not required. A similar question arises in connection with changes to be made in lease agreements executed before March 1, 2013.

The current law application practice does not make the situation clearer either. On January 25, 2013, the Plenum of the Supreme Arbitration Court adopted changes to the Plenum's Ruling on Certain Issues of Application of the CC Rules on Lease Agreement, dated November 17, 2011, No. 73 (the "Ruling"). Clause 14 of the Ruling states that in the event of non-compliance with the rule on registration of a lease agreement, and if a court finds that the owner delivered the property for use and the other person accepted the property and the parties reached an agreement on the conditions of use, then it should be taken into consideration that such agreement bound them with the obligation that cannot be arbitrarily changed by one of the parties. Thus, the SAC explains that the absence of state registration of the lease agreement does not serve as a ground for recognizing it as not having been entered into. It should be noted that Clause 14 was discussed before the adoption of the Law and does not fully reflect the essence of the changes being introduced thereby, in particular abolishment of the state registration of lease agreement.

Furthermore, in his Letter of January 22, 2013, No. 3.3-6/94, the Chairman of the State Duma Committee for Civil, Criminal, Arbitration and Procedural Law stresses that the requirement of state registration of transactions with real estate will not apply from March 1, 2013, but any encumbrance of real estate will still be subject to state registration. At the same time, the Letter indicates that in connection with the abolishment of lease agreement registration still subject to registration should be lease (right of lease) itself as encumbrance *on the basis* of the lease agreement. It should be noted that the Letter is not a regulation, but insofar as it clearly purports to disperse the legal uncertainty, corresponding legislative initiatives

removing the problem are likely to be taken in the near future.

The Law also introduces a **new mechanism of legal protection concerning disputable real estate**. In particular, the objection of a person holding prior right to real estate may be recorded in the state register against the corresponding registered right of another person. The objecting person should contest the registration in court within three months, otherwise the record is to be cancelled and may not be made again. The person contesting the registered right in court is entitled to claim that the fact of the court dispute over the right be recorded in the state register. Such measures are aimed at precluding misappropriation of property by consecutive repeated resale of disputable property.

The Law also establishes that **state registration** of rights to property is to be carried out on the basis of the principles of verification of legality of the grounds for registration, openness and credibility of the state register. On the other hand, the Law introduces a new rule on **compensation by the state of losses** caused by a wrongful refusal or avoidance of state registration of rights to property or recordation of illegal or false information about the right through the fault of the registering authority. In our view, such novel constitutes a currently justified means of protection of rights infringed as the result of misdeeds/negligence of bad-faith registrars and would make it possible to stand on the defense against unjustified delays and refusals of registration, and protraction of the registration process on the part of the registering authority.

Abuse of Right

Amended Article 10 of the CC regulating the issues of the abuse of right defines it as follows: **abuse of right** means the exercise of civil rights exclusively with the aim of causing harm to another person, actions in circumvention of the law with illicit purpose, and other knowingly bad-faith exercise of civil rights. Thus, the forms of abuse of right have been made more definite and have the corresponding qualifying features.

One of such forms - **actions in circumvention of the law with illicit purpose** – is the least evident legal category from the viewpoint of the accuracy of qualification. The lack of any criteria that would allow qualifying the actions of persons as actions in circumvention of the law (apart from their illicit purpose) clearly creates a legal uncertainty. Insofar as the statutory legal consequences of such actions are fairly serious – denial of protection of right, criteria and approaches to the qualification of such actions would inevitably have to be developed by court practice.

Thus, during the transitory period the risk of legal uncertainty would be the highest. One of the risk zones is contestation of transactions. In view of the court practice of application of Article 10 as it currently reads, transactions are still likely to be found invalid on the said

ground. But it is hard to predict the outcome of consideration of whether or not there existed actions in circumvention of the law as a form of abuse of right. The judgmental nature of the actions (in circumvention of the law) and their legal qualification is evident. Therefore it would take serious efforts to prove that such kind of abuse took place or did not take place.

Besides, worthy of noting are **changes in the consequences of abuse of right**. The currently effective Article 10 allows a court to deny protection (“a court may deny”) if it finds that the prohibition on abuse of right was violated. Amended Article 10 formulates this rule as follows: “a court shall *deny* protection of the person’s right in full or in part and shall also *use* other measures stipulated by the law, taking into consideration the nature and circumstances of the committed abuse”. If constructed literally, the rule creates an impression that the court automatically applies the said legal consequences. However, the legislator was unlikely to have in mind the obligation of the court. Besides, there may be variations – partial or full denial of protection, and there are set conditions of application – the court should take into consideration both the nature and circumstances of the committed abuse. In general, this creates grounds for court

practice to become varied and, consequently, the need to develop a uniform approach to the

application of the said rule by courts.

Legal Capacity of Individuals

The scope of grounds for recognizing an individual suffering from a mental disorder as partially capable has been broadened to include, inter alia, addiction to gambling. In pursuance of the Regulation of the RF Constitutional Court, dated June 27, 2012, No. 15-P, Chapter 3 of Part One of the CC has been amended to differentiate civil-law consequences of an individual's mental disorder in proportion to the degree of the actual weakening of his ability to understand the meaning of his actions or control them.

The procedure for determination of civil-law transactions which a person with limited legal capacity may make independently, depending

on the intensity of the individual's mental disorder. In particular, such individual may independently dispose of his salary, make small domestic transactions and transactions aimed at getting free benefits (not requiring notarization or state registration); dispose of the money provided by his lawful representative for a certain purpose or for free disposal. Other transactions are to be made with a written consent or subsequent approval of the custodian.

The said changes will come into force upon expiration of three years from the effective date of the Law.

Private Farms

The Law secures the right of individuals carrying out joint activity in the agricultural area without incorporation to organize a legal entity on the basis of an agreement for setting up a peasant (farm) economy (the "PFE"). Article 86.1 of the CC being introduced by the Law regulates the legal status of such PFE. In particular, a PFE has the following peculiarities:

- it is a voluntary association of individuals on the basis of a membership;

- the PFE members participate personally in the agricultural activity of the PFE;
- the PFE operates on the basis of the property contributed by the PFE members;
- the property of the PFE is in the ownership of the PFE;
- the PFE members bear subsidiary liability for the obligations of the PFE.

Apparently, there would follow a corresponding law regulating the status, procedure for setting up and activity of the PFE.

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