

Courts Throw Shadow Over Property Rights

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Commercial property dealings are invariably complex, and due diligence is practiced and preached by legal advisers around the world. But recent court rulings in the Russian legal

system mean that it needs to be emphasized again with the ability of third parties to lay some form of claim in circumstances where contracting parties have not been and may still not be aware of any potential for claim being overtly recognized.

Registration and Russian Land and Property Use

All property ownership in Russia and leasing extending beyond one year are required to be registered in a property register maintained by regulatory authorities, which is comprehensive and intended to be historically detailed. Registration then enables transfer rights with the right of ownership stemming from the moment of registration and failure to register invalidating transactions.

Traditionally, registration has been seen as offering some form of surety about property with registering applicants needing to supply documentation forming the basis of their right. Developers need to possess proper titles to land and have a construction permit. All land usage must also comply with relevant regulations and laws, and failure to use property in compliance with laws can pose major risks for purchasers. The registration of property rights and related transactions is the only evidence of an existing registered right, meaning that registration should be very closely examined. All specific details relating to a property, including ownership and usage, should be examined.

Property purchasers need to demonstrate that they are diligent purchasers and have sought to ensure that there are no competing claims on a given property. Until recently, it has been generally accepted that if a property is registered to a particular owner then the veracity of the title to it was reasonably sure as a property right.

Recent Developments in Interpretation of Registration

The Supreme Court and the Supreme Arbitration Court issued a joint guidance, No. 10/22 of April 29, 2010, clarifying the relationship between the law, the property register and property use.

The guidance says a purchaser is showing appropriate diligence if he can demonstrate that, at the completion of a transaction, he does not know about any illegitimacy on the part of the seller and, in particular, has undertaken all legitimate measures to determine the rights of the seller regarding the transaction.

The purchaser cannot be recognized as diligent if the property has not been registered by the seller or if there are any annotations in the register indicative of a judicial dispute concerning the property. At the same time, a good record in the registry, solely of itself, is not proof of the conscientiousness and bona fide status of the buyer.

Guidance also makes clear that an entry in the property register does not mean that a building is necessarily authorized and that it cannot be pulled down, as well as making clear that there is no limit to what may be pulled down if it turns out to be unauthorized. Finally and very significantly, the guidance affirms that there is no statute of limitations on cases involving such unauthorized facilities.

Essentially, legal guidance makes the status of the property registry one of an information

database and not one of an authorization or approval of a process. Then this means that where a property transaction has been registered and is subsequently shown to have been unauthorized, then any development or use of that property may also be unauthorized and that such development may be removed. Finally, it means that a party that may have claim to a property, whether or not this has been registered, does not lose this claim through the operation of a statute of limitations in cases involving the property register.

The most recent guidance underlines the vital importance of conducting a thorough due diligence in all real estate transactions in order to ensure that there are no third party claims on the property involved. It places an onus on the purchaser to demonstrate that, at the moment of the transaction, there was no reasonable basis for being aware of other claims to the property or of claims about the seller's capacity to do so. It states overtly that relying solely on registration is not a demonstration of sufficient diligence.

Judges have stated their suspicions about the property registration system, and the value of a record in the registry has been devalued. Buyers need to more thoroughly check property rights of any real estate purchases. We have been advising our clients that now it is overtly stated that the register is not the last word, it means that all property buyers really have to focus on their due diligence. We have been doing this at Goltsblat BLP for a long time, have known that there were flaws in the registration process and keep our clients aware of them and what their options are.

Due Diligence

Investors in property need to determine the potential risks of any major transaction. In common with jurisdictions all over the world, due diligence is essential in Russia, and indeed it may be considered that, given the complexity of legislation and the historical, administrative and social development of property as an asset class in Russia, it is more necessary in Russia. Unlike many other mature jurisdictions, due diligence in Russia should cover the historical background of the property concerned to the greatest extent possible, rather than be limited to a verification of the most recent transactions.

Due diligence in Russian commercial real estate will establish the veracity of property from the point of privatization, availability of permits and authorizations required, and determine whether there are third parties beyond the seller and the potential buyer that may have claims on a property. A good due diligence process will confirm the privatization process, or sales process by authorized bodies, and research through registrations of subsequent owners to identify usage and all relevant laws applicable to a property, as well as match these against planned usage by a purchaser.

In conclusion

The guidance of the Supreme Courts of Russia has made it very clear that the property register of itself is no guarantee of the veracity of any title to a property available for purchase, but rather is an information database. All property buyers should ensure that all titles and documentation for any property they are considering investing in is free from risks of claims by third parties. The only way to ensure this is through a thorough due diligence process undertaken by qualified lawyers, experienced in handling Russian property issues.

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