



The Business & Law Readers Digest

**Land Law:
Developments during 2007
and Market Prospects**

Banking and Finance // Beverages Industry // Corporate // Corporate Dispute Resolution // Due Diligence // Employment // Financial Services // Insurance // Investments // Kyoto Protocol Implementation // Logistics // Mergers and Acquisitions // Natural Resources // Oil and Gas // Representative Office // **Land** // Ukraine and the WTO // Ukraine and Russia // Tourism



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Regulatory developments during 2007

In 2007 the development of Ukrainian land regulations was not major but still significant. No profound new laws were adopted but the amendments to the existing laws are worthy of mention.

Firstly, in order to continue a sort of tradition, the Law of Ukraine "On the State Budget for 2007", adopted on 19 December, 2006, introduced changes to the Land Code of Ukraine. Article 129 of the Land Code was amended, with the provision that the sale of land plots containing objects which are subject to privatisation to foreign countries and foreign legal entities is to be performed by state privatisation bodies under the assignation of the Cabinet of Ministers and upon the approval of the Verkhovna Rada. This amendment almost eliminated the opportunity to privatise attractive objects from abroad, as the procedure of approval for such sales by the Verkhovna Rada is not - and never was - provided by effective law.

Then, on 27 April 2007, the Law of Ukraine "On Amendment and On Recognition of Particular Legislation Acts of Ukraine with Respect to the Adoption of the Civil Code of Ukraine" was adopted, despite the fact that the Civil Code of Ukraine has been effective since 2004. This law was adopted in order to amend other laws, and introduced the main concept for Ukrainian legal regulations in this sphere. Article 120 of the Land Code was

amended so that the individual or entity who purchases the title to real estate automatically acquires the title to the underlying land plot, with no allotment change to the latter. Should the dimensions of the land plot not be provided in the purchase agreement, the purchaser shall acquire the title to that part of the land plot which underlies the building, plus the part necessary for the maintenance of such building. The amendment described above has determined the adoption policy for subordinate legislation, as numerous acts adopted since these changes came into effect contained this principle.

The interesting tradition of making amendments to land regulations by adopting the state budget for the respective year has continued in 2008. Due to changes in the government - and the consequent changes in the country's internal policy - the newly adopted Law of Ukraine "On the State Budget for 2008" of 28 December 2007 also introduced amendments into Ukrainian land legislation. The procedure for the sale and lease of land plots through competitive means was modified. The abovementioned law had abolished the sale and lease of land plots through tender procedure, only leaving potential purchasers and lessees the opportunity to obtain land plot titles through auctions. In other words, the non-monetary criteria for bids are no longer applicable in 2008 and only



the best financial offer will guarantee success. The "Transition Provisions" clause of the Land Code which establishes the well-known moratorium on sale and change of allotment of agricultural land

was also amended. The moratorium term was prolonged until the date when the Laws of Ukraine "On the State Land Register" and "On the Land Market" will enter into force.

The peculiarities of land law with respect to foreign investments

Despite the well-publicised mild investment climate, the situation regarding land acquisition in Ukraine by international companies for their business needs and day-to-day operations remains rather strict and captious.

Article 82 of Land Code of Ukraine provides that foreign legal entities can acquire a title to non-agricultural land plots within the boundaries of settlements for real estate object acquisition and for the purpose of construction of real estate objects connected with the entrepreneurial activity of a legal entity in Ukraine; and outside the settlement's boundaries for real estate object acquisition. In other words, a foreign legal entity's chances of acquiring a land plot title is directly connected with the ownership title to the real estate located at that land plot. Practically, the best conditions under which a foreign company may acquire a land plot in Ukraine is if the ownership title to the real estate has already been acquired.

Ukrainian lawmakers had also foreseen the understandable desire of foreign investors to avoid the previously-mentioned bans. The same Article 82 of the Land Code stipulates that "joint enterprises established with the participation of foreign legal entities and individuals can acquire titles to non-agricultural land plots under the procedure set for foreign legal entities". However, Ukrainian company law does not recognise such a term as "joint enterprises established with the participation of foreign legal entities and individuals". Therefore, the Land Code provision in question can be ambiguously interpreted: (1) as a ban for any legal entities in which foreign companies own shares to acquire agricultural land plots; or (2) as a prohibition from acquiring such agricultural land that only applies to companies established in a legal form of joint venture.

From one angle, the first interpretation allows us to assert that any legal entity established under Ukrainian law and having foreign shares is allowed to



acquire land plots under the procedure set for foreign legal entities, and is banned from acquiring agricultural land plots, regardless of the legal form of such entity and the amount of its charter capital owned by the foreign legal entity or individual.

From the other point of view, taking into consideration the fact that effective Ukrainian legislation provides the opportunity to establish a company in the legal form of a joint venture, and that joint venture companies themselves constitute a small minority of companies, the second interpretation claims that it is an indulgence for foreign-owned companies to be established in a form other than joint venture in order to acquire titles to land plots under the procedure set for foreign legal entities.

This inconsistency has spawned diverse law enforcement practices. This often happens when the same regulatory authorities interpret a Land Code provision in different ways, in one case in an extremely tolerant manner as far as the land owner is concerned, and in another initiating claims to invalidate the contract for the acquisition of the land plot.

Foreign legal entities may not acquire titles to agricultural land. Even in cases when the company has inherited an agricultural land plot, its title is subject to mandatory alienation within a one-year term.

The procedure for the sale of land plots to foreign legal entities is provided for in Article 129 of the Land Code of Ukraine. In accordance with this Article there are two different sale procedures, for land plots owned by state and by local communities correspondingly. In terms of state-owned land plots, their sale to foreign legal entities shall be conducted by the Cabinet of Ministers of Ukraine, subject to approval by the Ukrainian parliament. The sale of community-owned lands to foreign legal entities shall be performed by the respective city or village councils, subject to approval by the Cabinet of Ministers of Ukraine. However, in order to buy a land plot in Ukraine, the foreign legal entity is obliged to register its representative office (one that is entitled to conduct economic operations in Ukraine), whether the land plot that it plans to purchase is a state-owned or community-owned.

Sometimes the existing practice of community-owned land plot sale excludes the approval of the Cabinet of Ministers, involving in the sale only the respective council as a seller. Instead, to fully guarantee the new owner's title to its land plot and to protect him against possible invalidation of the sale-purchase agreement, the new owner initiates an action in order to confirm the title to land plot recently purchased via court decision.

Paragraph 5 of Article 129 of the Land Code of Ukraine provides the following acquisition procedure. A foreign legal



entity that intends to acquire a land plot submits an application to the respective state administration (if the land plot in question is state-owned) or to the respective local council (if the land plot is community-owned). Then, the administration or council examines the application and applies for approval by the Cabinet of Ministers of Ukraine. Therewith, the registration certificate for a representative office and the land lease agreement for the land plot are provided by the applicant. Resulting from the analysis of the abovementioned Land Code provision, the foreign legal entity is obliged by Ukrainian law to register a representative office and to execute a land lease agreement on the lease of the land plot which it intends to acquire. Regarding the acquisition of community-owned land in Kyiv, in accordance with the decision of Kyiv City Council dated 14 March 2002, prior to it being passed for the approval of the Cabinet of Ministers of Ukraine the application is to be processed by the Main Administration of Land Resources in the city of Kyiv.

It should also be mentioned that neither the terms nor the procedure of the Cabinet of Ministers' approval of land plot acquisition are stipulated by the effective Ukrainian law. Ukraine's unique legal environment tolerates the acquisition of land plots from legal entities and individuals by locally-registered companies owned by non-residents without any approvals. Despite the risks, this scheme is well-known and relatively widespread.

Obviously, the procedure of land plot acquisition by foreign companies in Ukraine is rather sophisticated and unreasonably overstructured. It can also be blamed for attracting corruption schemes. However, the profits which can be received from investments into Ukraine today can more than compensate for the risks and efforts undertaken by a foreign investor.

To acquire an ownership title to agricultural land the foreign investor will need either to establish a holding company in Ukraine, or to involve a Ukrainian partner. To avoid the risk of land plot invalidation it is recommended to establish a subsidiary of a Ukrainian holding company - an operating company - which will be the owner of the land plot title. By acting in this way, the foreign investor will avoid the ban for agricultural land acquisition stipulated by the Land Code. This approach is also convenient for acquisition of non-agricultural land, as the operating company established by the Ukrainian holding company will be free of any restrictions to acquire land.

An approach envisaging the participation of a Ukrainian company as a partner also allows them to escape the abovementioned bans and restrictions. Besides, the knowledge of Ukrainian culture and business techniques which local companies possess helps their partners to avoid many risks and potential problems, which foreign investor may face if acting alone.



Privatisation issues: moratorium and the existing practice

The infamous moratorium, which prohibits the sale and change of allotment of agricultural land plots, became a Ukrainian legal reality at the end of 2006. During these two years, Ukrainian lawyers and businessmen have elaborated certain mechanisms to avoid adherence to the existing moratorium. Our broad experience on this issue allows us to assert that the legal norms established by the moratorium contain major defects. Such a situation brings to life various approaches, using which the business groups interested in the acquisition of land titles may reach their goals without violating the law.

One of the existing approaches includes the following steps. Taking into account that the moratorium does not prohibit the acquisition of a title to land plot through an enforced seizure of property backed by a court decision, the existing practice is for the seller of an agricultural land plot

to borrow an amount of money equal to the land plot's fair market price from the future purchaser of the land plot. After the breach of loan repayment terms the lender files a claim to the court. At this moment the borrower must become free of all assets except for the land plot. When the court establishes that the defendant (the land plot owner) is incapable of repaying the loan due to lack of assets, the plaintiff amends its claims by asking the court to enforce seizure of the defendant's property. In this case the defendant supports the plaintiff's claim and the parties reach an amicable settlement under the lawsuit - to call in the loan by transferring title to the land plot to the plaintiff.

The above approach is one of many similar schemes. Other approaches include barter agreements, private arbitration courts and other legal mechanisms.

Acquisition of land plot titles through tenders/auctions

The Land Code of Ukraine stipulates the possibility of acquiring a land plot title, by ownership or lease, on a competition basis. In 2007 both tender and auction acquisition procedures were used. The acquisition procedure for tenders provided the participants with the possibility to

strengthen their financial bids by non-monetary obligations, such as infrastructure development or similar responsibilities, and the auction procedure provides simple evaluation of best-price offers. Due to non-transparency in the tender procedure and the existence of various



regulations on it in different regions of Ukraine it was highly criticised. By contrast the auctions, which were much rarer than tenders in 2007, were appraised positively by the participants and media, as well as by the authorities. According to the media, the most expensive land plot sold in 2007 by Kyiv city was of a total square of 113.53 ha. The planned purchaser's allocation for this land plot was residential development and the auction-winning bid amounted to approximately 1 billion hryvnya.

The adoption of the Law of Ukraine "On the State Budget of Ukraine for 2008" had excluded the tender procedure from the list of land acquisition procedures, making an auction the only competition-based method by which it is possible to acquire a title to a land plot. According to the official statement of Kyiv City State Administration, in 2008 seven land plots with a total square of 2.371 ha will be auctioned.

Market Prospects

Without a doubt, the disadvantages of the existing law regulations have not escaped unnoticed by Ukrainian lawmakers. The Cabinet of Ministers of Ukraine has developed a law draft providing an amendment to Article 82 of the Land Code of Ukraine. In accordance with the said draft, the provision regarding joint enterprises established with the participation of foreign legal entities and individuals, and its' right to acquire titles to land plots, will be excluded. Such an amendment will significantly simplify the procedure, because from the date of its entering into force all legal entities established under the laws of Ukraine, regardless of whether the owner of its shares is local or foreign, will have the same rights to acquire land plots as legal entities established by Ukrainian companies and individuals do today. For the moment the outlook for new foreign players emerging in the Ukrainian land

market are not so rosy, as the market itself seems sufficiently mature, and the quantity of domestic market players relatively high. However, there do exist opportunities to enter the market, and they are substantially dependant on cooperation with the domestic market participants by implementing investment projects based on joint activity.

The harmonisation of legislation, and its' adjustment and development toward the highest international standards, as well as the future abolition of land law restrictions for non-residents, shall be catalysts for investing significant amounts into the Ukrainian land market. As for the existing legislation, it often forces the foreign investor to seek alternative routes for investment, which leads to the reduction of cost-effectiveness, and influences the prospects of investments.

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