

# CIS AND CENTRAL EUROPE LEGAL NEWSWIRE

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#### RUSSIA

## Housing Bill Aims to Facilitate Lending and Reduces Notary Fees

On September 25, 2004, Russian Federation ("RF") Law No. 104-FZ "On the Introduction of Amendments to Article 4 of the RF Law 'On State Duties,'" entered into force (the "Amendments"), reducing significantly the state duty for notarization of a mortgage agreement by a Russian notary. The Amendments were proposed to the RF State Duma along with 26 other bills as part of a package designed to develop the housing market in Russia. Details on the Amendments and certain elements of the housing bill package are discussed below.

### Decrease in Notary's Mortgage Fees

The Amendments abolish the unjustifiably high state duty for notarizing a mortgage agreement, which previously equaled 1.5% of the value of the mortgaged property. Currently, the state duties for notarizing mortgage agreements are as follows: (i) 200 Rubles (approximately US \$7) for notarizing residential mortgages, if the mortgage secures a loan granted for the purchase or construction of such mortgaged property; and (ii) 0.3% of the mortgaged property value, but not exceeding 3,000 Rubles (approximately US \$100), for notarizing mortgages on all other kinds of real property.

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#### UKRAINE

## Procedure for Obtaining Foreign Currency Loans Revised - Interest Rates Subject to Cap

Foreign lenders financing Ukrainian entities will now need to take into account two recent resolutions issued by the National Bank of Ukraine (the "NBU"), which may impact on their transactions and, in particular, on the applicable rates of interest. The first, NBU Resolution No. 270 "On the Procedure for Residents to Obtain Credits and Loans in Foreign Currency from Non-Residents and the Extension of Foreign Currency Loans by Residents to Non-Residents" ("Resolution 270") which came into effect on August 15, 2004, provides a welcome consolidation of general requirements for foreign currency loans and also gives Ukrainian lenders the ability to issue foreign currency loans to foreign borrowers. However, the application of certain provisions, particularly the revised method for calculating interest paid for the use of a loan, remain unclear and could potentially impact on the way such loans are structured. The second resolution, No. 363 "On Establishing Interest Rates for Foreign Borrowings of Residents," effective September 3, 2004, sets new maximum interest rates for such loans.

In this article we describe the most important features of Resolution 270 and Resolution 363, focusing, in particular, on the provisions concerning interest rates.

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By introducing a specific cap on notary fees, the Amendments also eliminate a major economic basis for underestimating the value of mortgaged property in a mortgage agreement. While RF Law No. 102-FZ "On Mortgages (Pledges of Real Estate)", dated July 16, 1998, as amended (the "Mortgage Law") do not contain any particular rules for determining the value of mortgaged property, which in practice is determined by the parties to an agreement, many debtors sought to declare a lower property value in the mortgage agreement in order to reduce the applicable notary fees. However, under previous bankruptcy legislation, a lender's claim with respect to pledged property was generally recognized as a secured claim only to the extent of the value of the pledged property set forth in the relevant mortgage agreement, and thus the lender could be treated as an unsecured creditor with respect to the remainder of the claim. Consequently, a property's declared value was often a point of dispute in concluding a mortgage agreement, and posed a potential risk to creditors. This risk to creditors was reduced significantly by RF Law No. 127-FZ "On Insolvency (Bankruptcy)," dated October 26, 2002 (the "Bankruptcy Law") which provides that a secured creditor's claim is satisfied out of the proceeds of the sale of the property securing the claim prior to payments to other creditors of the same or lower priority (*see* the February 14, 2003 *CIS Legal Newswire* for a discussion of the Bankruptcy Law).

The Amendments also eliminate the state duty for registering mortgage agreements and issuing a state registration certificate, as well as the state duty for obtaining an extract from the Unified State Register of Rights to Real Property and Transactions Therewith - the only valid legal basis for evidencing rights to real property.

### Other Developments in Russian Real Estate Law

The housing bill package also included, *inter alia*, bills on the following: (i) amendments to the RF Tax Code; (ii) amendments to the Mortgage Law; (iii) amendments to RF Law No. 122-FZ "On State Registration of Rights to Real Estate and Transactions Therewith", dated July 21, 1997, as amended; (iv) the new RF Housing Code; (v) the new Town Planning Code; (vi) a proposed law "On Credit Histories" (the "Credit Histories Bill"); and (vii) amendments to RF Law No. 1738-1 "On Land Fees", dated October 11, 1991, as amended.

Among the major tax changes brought by the housing bill package are the exemption of sales of land plots and residential premises from payment of value added tax, and the exemption of individuals from personal income tax on proceeds of up to 1,000,000 Rubles from the sale of residential premises held for more than three years (currently, this benefit applies only when premises have been held for five years). These tax exemptions enter into effect on January 1, 2005.

The Credit Histories Bill was adopted in the second reading in July 2004 and must pass through further stages in the legislative process to become law. The bill provides for the establishment of credit history bureaus, in particular, a Central Bureau under the supervision of the RF Central Bank, which will accumulate information on borrowers and their loan operations. Generally, the bill envisages that each borrower will be assigned a unique code permitting such borrower to access his/her credit history file. At the borrower's request, a bureau may issue a report on the borrower's credit history to a credit institution. If the Credit Histories Bill becomes law, banks are likely to become more active in providing loans to individuals, thereby potentially creating a housing boom in Russia. / E. Abrossimova

## New Commercial Secrets Law Should Prevent Unfair Competition

After two years of debate, RF Law No. 98-FZ "On Commercial Secrets" (the "Commercial Secrets Law"), finally came into effect on August 15, 2004. By providing a firmer legal basis for using information constituting commercial secrets, the Commercial Secrets Law should help to prevent unfair competition practices and provide better protection to businesses and entrepreneurs alike. The Commercial Secrets Law defines the concept of commercial secrets, provides measures to be taken for their protection, sets forth rules for operations involving commercial secrets and, most importantly, establishes consequences for illegal disclosure thereof.

### Definition of a Commercial Secret

The Commercial Secrets Law defines a commercial secret as any information, the possession of which allows or could

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allow its holder (*e.g.*, a company or individual entrepreneur) to increase its income, avoid unjustified expenses, maintain a position on a specific market for goods or services, or obtain other commercial benefits as a result of such secret. A commercial secret may be comprised of any scientific, technological, industrial, financial, economic, or other kind of information (including manufacturing secrets or know-how) that: (i) possesses actual or potential commercial value because it is unknown to third parties; (ii) is not freely accessible by legal means; and (iii) has been placed by its holder under a commercial secrecy regime. Any information meeting the above criteria may constitute a commercial secret, regardless of the form in which it is recorded.

As a general rule, the holder is free to determine which information constitutes a commercial secret. However, certain restrictions apply, including with respect to information on: (i) legal entities and individual entrepreneurs contained in foundation documents or state registers; (ii) the number and composition of employees, working conditions (including workplace safety), the rates of industrial injury and occupational disease, and the existence of employment vacancies; (iii) the auctioning or bidding terms for privatizing state or municipal property; and (iv) pollution, sanitary and epidemiological conditions.

### Commercial Secrecy Regime

As noted above, the Commercial Secrets Law requires holders to establish and maintain a particular regime for all commercial secrets to safeguard their confidentiality. This regime must include taking, *inter alia*, the following measures: (i) establishing a list of information classified as commercial secrets; (ii) restricting access to commercial secrets by adopting regulations on their use and monitoring compliance with such regulations; (iii) registering all persons who have access to commercial secrets; and (iv) stamping any materials containing a commercial secret with the words "Commercial Secret."

### Rules for Operations Involving Commercial Secrets

The Commercial Secrets Law also provides, for the first time, a legal framework governing confidentiality issues between an employee and an employer. If the holder/employer fails to establish or comply with a commercial secrecy regime as described above, employees can not be held liable for disclosing commercial secrets. An employer must also formally notify an employee when he/she is given access to information classified as a commercial secret, and the fact of such notification must be officially recorded (*e.g.*, the employee and employer sign a

special act). Following dismissal, an employee is obliged to keep commercial secrets confidential for the term established by a relevant agreement entered into between the employee and employer during employment or, if no such agreement exists, for three years after termination of employment.

Issues related to commercial secrets arising between the holder of a commercial secret and its counter-party under any civil law agreement are governed by such agreement and by applicable law. The Commercial Secrets Law obligates parties to include a specific confidentiality clause in agreements stating the terms and conditions under which information is disclosed by one party to another. This confidentiality clause must establish the recipient party's obligation to pay compensation for losses caused by disclosure of a commercial secret. In addition, the Commercial Secrets Law requires the recipient party to immediately notify the holder of the commercial secret of any disclosure, or threat of disclosure, or of any illegal acquisition or use of the commercial secret by a third party.

The Commercial Secrets Law entitles state and municipal bodies to request information classified as a commercial secret if they have grounds to do so, and obliges the holder to provide the requested information free of charge. If a holder refuses, the state or municipal body may seek enforcement of their rights through a judicial procedure. In addition, the holder of a commercial secret, as well as state or municipal bodies which have accessed commercial secrets, must provide such information to courts, prosecutors' offices or preliminary investigation agencies upon their request.

### Illegal Disclosure of a Commercial Secret

The Commercial Secrets Law defines illegal disclosure of a commercial secret as any action or failure to act which results in a third person's knowledge of the commercial secret in any form (oral, written, or other, including by technical means), without the consent of the holder or in violation of a civil law agreement or employment contract. As a general rule, the Commercial Secrets Law provides for compensation for all damages caused by the illegal disclosure of a commercial secret. However, certain limitations are placed on the holder's right to damages. For example, the right to seek damages against an employee is qualified by the following conditions: (i) the employee must be guilty of disclosing a commercial secret; (ii) the employee must have accessed the commercial secret as part of performing his/her job; and (iii) the employee must have disclosed the secret during the applicable limitation period (as established by an

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agreement, or three years following the termination of employment). In addition, the Commercial Secrets Law excludes liability of any person who has accessed a commercial secret by accident or by mistake, or who had no reason to consider the use of the commercial secret as illegal.

The amount of compensation that should be awarded to holders in the event of illegal disclosure of a commercial secret is not specified in the Commercial Secret Law. Indeed, this issue was one of the major points of contention between the Duma and the Federation Council when the bill was under debate. The bill originally approved by the Duma provided for compensation ranging from 50 to 50,000 times the minimum monthly wage, with the particular amount to be determined by a court in each particular case. The Federation Council, meanwhile, advocated a formulation in which the amount of compensation awarded to the holder of a commercial secret would be based on the damage caused by the disclosure. Certain representatives believed that establishing a specific amount by law could potentially encourage holders to make fraudulent allegations in order to receive compensation. As a result of the work of the conciliation commission, in its final form, the Commercial Secrets Law does not include any specific amounts of compensation to be paid for illegal disclosure of a commercial secret.

### Conclusion

It is clear that the enactment of the Commercial Secrets Law represents a very positive step forward in safeguarding confidential information in the RF, which should provide greater security to businesses and incentives to entrepreneurs. However, at the same time, much will depend on how this new law is enforced in Russian courts in order to render it meaningful. / *E. Abrossimova*

## Issuance of Subsoil Licenses Centralized; "Two-Key" System Abolished

On August 31, 2004, amendments to RF Law No. 2395-1 "On the Subsoil," dated February 21, 1992 (the "Amendments") entered into force. The Amendments abolish the long-standing "two-key" system of issuing mining licenses,

whereby a license was granted on the basis of a mutual decision by federal and local authorities. The centralization of the system for issuing mining licenses is consistent with the RF Government's current general policy of strengthening the power of the federal government.

Under the Amendments, local authorities are no longer authorized to make decisions on issuing subsoil licenses, except in relation to common minerals, geological collections materials, and subsoil plots of local significance. Local government participation in the licensing process is now limited to mere representation on commissions established by federal governmental bodies in certain cases.

Federal governmental bodies now also have exclusive competence to determine the maximum size and number of subsoil plots and the maximum amount of mineral reserves, as well as to prepare the lists of subsoil plots available for exploration under production sharing agreements. In addition, federal rather than local governmental bodies now determine the specific amounts of regular payments for subsoil use. Local government bodies have also lost the right to receive a portion of certain payments related to subsoil use, such as payments for geological information, for participation in tenders and auctions, and for issuing subsoil licenses (with the exception of common minerals and subsoil plots of local significance).

The Amendments also introduce certain other changes. Namely, the Amendments specify that announcements for licensing auctions must be published at least 45 days in advance, and announcements for tenders at least 90 days in advance. In addition, the Amendments clarify that the subsoil user must pay the federal budget for an appraisal of mineral reserves, as well as for geological, economic and ecological information on subsoil plots available for exploration. The amount of such payments will be determined by the RF Government.

In general, the centralization provided for by the Amendments should simplify the process of obtaining licenses for mining companies, who have often found it more difficult to secure a favorable decision from local authorities. However, the "two-key" system of issuing licenses was based on provisions of the RF Constitution which recognize the dual jurisdictional nature of federal and local bodies over subsoil resources. Therefore, it is possible that the Amendments may be challenged in the RF Constitutional Court and, if acknowledged unconstitutional, could be struck down. / *S. Sineva, A. Kelina*

<sup>1</sup> The previous system has historically been referred to as a "two-key" system because of the need to receive permission at two stages (by analogy, to "unlock" two doors).

## Constitutional Court Ruling Restricts VAT Set-offs

On April 8, 2004, the RF Constitutional Court (the "Constitutional Court") issued Ruling 169-O (the "Ruling") in connection with a claim challenging the constitutionality of provisions of Article 171 of the RF Tax Code (the "Tax Code") regulating, among other things, set-offs of value-added tax ("VAT") payments. The Ruling, among other things, appears to restrict taxpayers' ability to set off incoming and outgoing VAT payments with respect to assets acquired with borrowed funds.

The Ruling upholds the legality of the provisions of Article 171 of the Tax Code relating to VAT set-offs. This decision was not in itself surprising; however, the Ruling also contained some troubling commentary on the core issues considered by the Constitutional Court.

As a general rule, Article 171 of the Tax Code allows VAT amounts due to the government to be set off by the amount paid to other taxpayers, such as suppliers, in order to decrease VAT obligations. In its interpretation of this provision, the Constitutional Court stated in the Ruling that a taxpayer must pay the full amount due in order to exercise the set-off right; in other words, the VAT payment to a supplier must be made in full and on the taxpayer's account. Surprisingly, the Constitutional Court also indicated that when borrowed funds have been used to pay the supplier, such expense becomes real for purposes of Article 171 only when the borrowed funds have been repaid. Thus, there is a substantial risk that taxpayers will not be able to set off VAT paid to suppliers with borrowed funds against incoming VAT until such borrowed funds have been repaid. To our knowledge, other RF courts have not yet expressed their view on the Ruling, and in several instances (at the lower court level) have upheld the rights of taxpayers to set off VAT even when it was paid with borrowed funds which remain outstanding. However, in a recently reported case, an appellate arbitration court remanded a case to the lower court, effectively affirming the Constitutional Court's position that a taxpayer may not set off VAT amounts paid with borrowed funds.

Several petitions have been submitted to the RF Government to resolve this matter, as clearly it may potentially significantly affect financing projects in Russia. We will, as always, monitor the situation. / *K. Konstantinov*

## Scope of Transactions Subject to Monitoring under Anti-Money Laundering Law Expanded

In response to new recommendations on counteracting money laundering issued by the Financial Action Task Force Organization ("FATF"), on July 7, 2004, the RF State Duma passed amendments (the "Amendments") to RF Law No. 115-FZ "On Counteracting Legalization (Laundering) of Profits Derived From Criminal Activity" (the "Anti-Money Laundering Law"), dated August 7, 2001 (please see the August 16, 2001 issue of the *CIS Legal Newswire* for a discussion of the Anti-Money Laundering Law). The Amendments were signed by the RF President on July 28, 2004 and entered into effect on August 30, 2004.

The Anti-Money Laundering Law created a state body responsible for monitoring certain transactions in excess of 600,000 Rubles (approximately US \$20,000), and introduced reporting requirements for certain entities (*e.g.*, banks and financial institutions) with regard to such transactions. The Amendments expand the scope of transactions subject to monitoring to include any interest-free loan between non-banking legal entities or between a legal entity and an individual in excess of the 600,000 Rubles threshold, as well as real estate transactions in excess of 3,000,000 Rubles (approximately US \$100,000). The Amendments also expand the reporting requirement to apply to real estate agents, brokers and other companies that mediate the sale and purchase of real estate.

Additionally, the Amendments require advocates, notaries, and entities or individuals rendering legal or accounting services to store certain information for five years following the termination of services to a client, and establish special internal control procedures with respect to certain client transactions. Such transactions include, among others: (i) transactions with real estate; (ii) managing a client's monetary or other assets, securities, bank accounts, *etc.*; and (iii) creating, managing and selling/purchasing companies or organizations, as well as attracting financing for such purposes. The wording of the Amendments implies that these transactions are not subject to mandatory reporting, unless there are reasons to believe that a transaction is being carried

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out for purposes of money laundering or financing terrorism. Unfortunately, the Amendments do not provide clear criteria for "suspicious" transactions, leaving this definition largely to the discretion of notaries, advocates and relevant entities.

It is also unclear if and how the liability for violating the new requirements will apply. The Amendments specifically provide that the reporting requirements do not apply to any information which qualifies for protection under an advocate-client relationship, in accordance with Russian law. However, no exceptions are made with respect to a notary's confidentiality obligations, which are also established by existing law. /E. Korotkova, A. Kelina

## RF Government's Privatization Plans for 2005 Still Uncertain

On August 26, 2004, the RF Government approved Order No. 1124-R containing its prospective plan for privatizing federal property in 2005 (the "2005 Privatization Plan"), which includes approximately 1,300 state-owned enterprises and more than 500 companies in which the State has equity ownership. In a spirit similar to other governmental actions with regard to privatization, the 2005 Privatization Plan, at least for now, appears to promote the general process of privatizing state enterprises and companies at a cautious pace.

The 2005 Privatization Plan provides for the privatization of, among others, Rosspirtprom, which owns around 200 spirit and alcoholic beverage factories, the Moscow-based bank TransKreditBank, the Ulyanovsk Automobile Plant, and one of Russia's largest shipyards located in St. Petersburg, Severnaya Verfy. Conspicuously absent from the 2005 Privatization Plan are Svyazinvest and Aeroflot, whose privatization had been widely expected following public statements by certain government officials. However, the 2005 Privatization Plan may be expanded on the basis of proposals from various ministries which were to have been submitted by October 1, 2004, leaving open the possibility that one or both companies may still be added to the plan. Indeed, recent statements by representatives of the Ministry of Economic Development and Trade indicate that a privatization plan for Svyazinvest will be submitted by October 15.

Prior to adopting the 2005 Privatization Plan, the RF Government had announced that it envisaged shortening the list of strategic enterprises and companies from approximately 3,000 to 200, to encompass only those enterprises and companies which are essential for national defense or safety, or for the State's operation. Since RF Law No. 178-FZ "On the Privatization of State and Municipal Property," dated December 21, 2001 (the "Privatization Law"), stipulates that strategic enterprises and companies may be privatized only by presidential decree (approval of a relevant privatization plan by the RF Government is not sufficient), reducing the number of strategic enterprises and companies would pave the way for further privatizations.

While the current list of strategic enterprises and companies, approved by Presidential Decree No. 1009 on August 4, 2004 (the "List"), reduced the number of such enterprises and companies to approximately 1,000, the List was more extensive than earlier suggested and contained companies in a wide range of sectors, including defense, communications, transport, energy, banking, construction and engineering. Companies whose privatization has been eagerly anticipated by investors, such as Svyazinvest, Aeroflot, Murmansk Commercial Sea Port, Vladivostok Commercial Sea Port, Irkutskenergo, Rosneft, Transneft, Transnefteprodukt, Vneshtorgbank, and Alrosa, among others, remain for now strategic enterprises, firmly in government hands.

Independent of the List, the Privatization Law provides that the railway monopoly and two state-owned companies in the energy sector, Gazprom and United Energy System of Russia, may be privatized only on the basis of a specially adopted law. During a meeting held by the American Chamber of Commerce in Moscow on October 1, 2004, Mr. Ivan Materov, Deputy Minister of Industry and Energy of the RF, stated that the privatization of the Russian electricity industry is inevitable. Mr. Materov also suggested that, ideally, reform of the electricity market should be carried out in a manner similar to the privatization of the Russian oil sector in the early 1990s. If this proves to be the case, privatization of the Russian electricity market may result in the establishment of several private producers of electricity with a company 100% owned by the State managing the electricity network, similar to Transneft, the state-owned company which controls and operates Russia's oil pipelines.

In conclusion, it appears that 2005 may bring a greater number of companies in Russia into private hands, but the timeline for further privatizations of many large state-owned companies remains unclear. /E. Abrossimova

## UKRAINE

### Procedure for Obtaining New Currency Loans Revised - Interest Rates Subject to Cap

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#### General Requirements for Foreign Currency Loans

With certain limited exceptions, all loans issued by a foreign lender to a Ukrainian borrower in foreign currency must be registered with the NBU. Registration must occur before any disbursements can be made, and the first disbursement must be made within 180 days after registration. The registration certificate is valid for the loan term and generally permits the borrower to repay the loan, provided, among other things, that all payments correspond to the amounts set forth in the certificate and the loan agreement.

Resolution 270 contemplates three possible scenarios for a foreign lender to disburse a loan: (i) directly to the borrower's foreign currency bank account in Ukraine; (ii) directly to the borrower's bank account outside of Ukraine; and (iii) directly to a foreign supplier of goods, work, services or intellectual property rights to be imported by a Ukrainian entity. For a loan to be disbursed to a borrower's bank account outside of Ukraine (and/or to be repaid from that account), the borrower must obtain a license from the NBU to open and maintain a bank account abroad. If the lender disburses the loan directly to the borrower's foreign supplier of work, services or intellectual property rights (but not goods), and the value of the underlying contract exceeds \$50,000, the borrower must obtain confirmation from the State Informational-Analytical Center for Monitoring External Commodity Markets that the contract price corresponds to market prices (or, in certain cases, approval from the NBU).

Ukrainian borrowers are required to use a servicing bank for foreign loans, primarily to monitor payments and to ensure that the amounts transferred to the lender correspond to the amounts received by the borrower, taking into account interest payments, commissions, *etc.*

#### Maximum Interest Rate

As with its predecessor, under Resolution 270, the NBU will not register a loan agreement if the interest rate exceeds the established maximum rate for foreign currency loans.

Previously, the maximum interest rate was 11% for most freely convertible (hard) currencies (*e.g.*, US Dollars, Euros), and 19% for loans in currencies with limited convertibility ("soft" currencies). Resolution 363 establishes new maximum interest rates for both hard and soft currency loans, setting the maximum interest rate for soft currency loans at 20% per annum, and the following maximum rates for hard currency loans:

- (i) for fixed rate loans:
  - with a maturity of up to 1 year - 9.8% per annum;
  - with a maturity from 1 to 3 years - 10% per annum;
  - with a maturity over 3 years - 11%; and
- (ii) for floating rate loans: 3-month US\$ LIBOR plus 750 basis points.

The NBU may, on a case-by-case basis, permit a Ukrainian borrower to deviate from the maximum interest rates if the borrower is financing a project that is strategically important for the Ukrainian economy. No other exceptions are expressly permitted.

The new maximum interest rates will not (except as noted below) affect the interest rates on loans registered prior to the effective date of Resolution 363 (*i.e.*, September 3, 2004). The interest rate specified in the registration certificate will generally continue to apply to the loan throughout the entire term, regardless of whether the NBU subsequently increases or decreases the maximum interest rate. If, however, the registration certificate is amended to increase the principal amount of the loan or to extend the certificate's validity (*e.g.*, to delay the final repayment date), the NBU will register the amendment only if the interest rate under the agreement does not exceed the maximum interest rate currently in effect.

#### Expansion of Applicability of Maximum Interest Rate

Under the previous regulations, foreign loans issued in foreign currencies were subject to a maximum interest rate in relation to the nominal interest rate charged by the lender. Resolution 270 fundamentally changes this concept by expanding the applicability of the maximum interest rate. Under the new regulation, when assessing whether the interest rate for the "use of the loan" exceeds the maximum interest rate, the NBU will now take into account not only the nominal interest rate,

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but also all commissions, penalties (*e.g.*, default interest) and other charges stipulated in the loan agreement.

Notably, the NBU has not explained what the term "other charges" includes, or how it will apply this new requirement. It appears from the language of Resolution 270 that "other charges" may be interpreted to include a variety of fees and charges customarily included in loan agreements concluded with foreign lenders, such as commitment fees, arrangement fees, *etc.*, that do not accrue throughout the loan term but are instead one-time or contingent charges. If the NBU simply aggregates all such charges at the outset, rather than considering the nature of the charges, the interest rate for the "use of the loan" for most existing foreign currency loan agreements in Ukraine would likely be deemed in excess of the maximum interest rate. Potentially, certain payments commonly included in loan agreements concluded with foreign lenders may no longer be permissible.

Furthermore, under Resolution 270, a loan agreement may not provide for the payment of interest before the loan proceeds are actually disbursed. Therefore, when drafting loan agreements foreign lenders may need to time the payment of any up-front commissions or other charges to immediately follow (rather than precede) the first disbursement under the loan.

In general, we anticipate that the NBU will reconsider the language of Resolution 270 and provide further clarification as to the components included when calculating maximum interest rates for loans.

### Limitation on Prepayment of Loans

Resolution 270 also introduces an effective cap on interest rates for the prepayment of foreign currency loans, by providing that payments for servicing a loan (*i.e.*, the interest rate) due to a foreign lender may not exceed the amount calculated by applying the maximum interest rate for the respective time period to the amount prepaid. This provision may not only prevent a foreign lender from obtaining the full amount of any prepayment fee (if the fee would result in the amounts charged by the lender exceeding the applicable maximum interest rate), but may also require a smaller maximum interest rate to be applied to the loan. For example, if a fixed-rate loan with a 10-year maturity period (which would normally be subject to the 11% maximum

interest rate) were to be pre-paid in year two, the interest rate and other charges on the loan might be subject to the maximum interest rate for 2-year loans, *i.e.*, 10%.

### Other New Concepts

Certain other new concepts established by Resolution 270 that lenders should bear in mind include the following:

**Provision on registration.** Foreign currency loan agreements must now contain a provision stating that the loan agreement will take effect only upon registration with the NBU. If the loan agreement lacks such a provision, the NBU may refuse to register the loan.

**Disbursement of a loan to a foreign supplier.** If a loan to a Ukrainian borrower is disbursed directly to a foreign supplier of goods, work, services, *etc.*, the Ukrainian borrower must confirm disbursement by submitting certain documentation to its servicing bank. Consequently, foreign lenders must provide their Ukrainian borrowers with notarized Ukrainian translations of certified payment orders confirming payment of the loan proceeds to the foreign supplier, and indicating the details of the contract between the borrower and the foreign supplier and the date and amount paid. Similarly, if a loan is disbursed to a Ukrainian borrower's account in a foreign bank, to enable repayment from the borrower's Ukrainian bank account, the foreign lender must provide the borrower with a notarized Ukrainian translation of certified payment orders confirming the payment of the loan proceeds and the subsequent use of the proceeds.

**Multiple borrowers.** The new regulations expressly provide for the possibility of multiple borrowers under a single loan agreement. In such a case, each borrower will be issued its own registration certificate, which must specify the corresponding amount of the loan to be disbursed to each borrower. It is not entirely clear, however, whether the regulations would allow for joint and several liability of each borrower.

**Denial of registration.** Under prior regulations, the NBU could deny registration of a loan agreement if the interest rate exceeded the maximum rate allowed or if the application was incomplete or contained inaccurate or contradictory information. In addition to these reasons, under Resolution 270 the NBU may now also deny registration if: (i) the foreign

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trade contract financed by the loan provides for the possibility that the goods, work, services or intellectual property rights to be provided thereunder will not be delivered, provided or otherwise carried out in Ukraine; (ii) the loan agreement contains terms and conditions indicating that the loan transaction is subject to financial monitoring (typically applies to transactions that could give rise to a suspicion of money laundering); or (iii) the loan agreement does not comply with the requirements of Resolution 270.

### Foreign Currency Loans from Ukrainian Borrowers to Foreign Lenders

Resolution 270 introduces an entirely new concept enabling Ukrainian residents to extend foreign currency loans to foreign borrowers, provided that: (i) the funds are lent from the Ukrainian resident's own foreign currency export proceeds remaining at its disposal after the mandatory conversion of 50% of such proceeds into Ukrainian hryvnia; (ii) the resident receives an NBU license to transfer foreign currency outside of Ukraine for the purpose of lending it to a non-resident; and (iii) the loan is secured by an irrevocable guaranty from a first class bank rated no lower than "A" by an international rating agency. This provision provides a legal basis for the growing number of Ukrainian companies who have expanded abroad (by acquisitions of foreign companies and otherwise) to finance the activities of their foreign affiliates.

### Conclusion

The verdict on Resolutions 270 and 363 appears to be mixed. On the one hand, Resolution 270 unifies previous regulations for foreign loans issued to Ukrainian borrowers in foreign currencies, and provides a welcome opportunity for Ukrainian lenders to issue foreign currency loans to foreign borrowers. On the other hand, while Resolution 363 establishes a slightly higher maximum interest rate for foreign loans in soft currencies, the maximum rates for fixed-rate short-term loans in hard currencies are now lower. Moreover, it is unclear how the change in the method for calculating the interest charged for the use of a loan will be applied. If not amended, it seems that this change could significantly impact the way that foreign loans issued to Ukrainian borrowers in foreign currencies are structured. /A. Ryzhova, A. Mycyk

## Bonds Issued to Reimburse VAT Debts

In an ongoing attempt to reform the system for issuing VAT refunds in Ukraine, which is widely regarded as ineffective, the Ukrainian Parliament recently allowed the Ukrainian Government to issue VAT bonds for VAT refund debts due to Ukrainian taxpayers as of June 1, 2004 and not reimbursed as of July 1, 2004. The VAT bonds mature on December 31, 2009. A previous bond issue for VAT refunds covered debts due as of November 1, 2003 and not reimbursed as of January 1, 2004, and also had a maturity of 5 years.

The total amount of both issues is about 2 billion Ukrainian Hryvnias (about US\$ 376 million), with the nominal value of a bond set at 1,000 Ukrainian Hryvnias (US\$ 188). The yearly coupon is calculated at the end of each year, at 120% of the refinancing rate established by the National Bank of Ukraine (the "NBU"), which is currently set at 7.5%.

VAT bonds are issued in non-documentary form by the Ministry of Finance, with the NBU acting as the general servicing agent for the bonds. VAT bond issuances are carried out by the State Treasury and certain Ukrainian banks, a list of which is established and published by the Ministry of Finance. The Ministry of Finance issues a global certificate of the bond issue and submits it to the NBU, which accounts for the bonds on the State Treasury's securities account.

Local offices of the State Tax Administration (the "STA") maintain registries and information confirming taxpayers' entitlement to VAT refunds. In general, a taxpayer being investigated or tried for tax evasion is not eligible for a VAT refund until the case is resolved. Eligible taxpayers must open a securities account in an eligible bank and provide the bank with excerpts from the STA's registry and an application to receive a VAT refund by means of VAT bonds. Each bank forms a registry of all account holders entitled to receive VAT bonds, which is submitted to the State Treasury. The State Treasury reviews the bank's registry to verify that the information therein corresponds with the data kept by the STA, then orders the NBU to transfer an appropriate amount of VAT bonds to the bank. The bank must then transfer the bonds to taxpayers' accounts within 3 days.

In general, the system of reimbursing VAT debt from the state budget to Ukrainian taxpayers by means of bonds is regarded

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unfavorably, mainly because the market for such bonds, which trade at a discount of approximately 20%, is relatively illiquid. While eligible taxpayers view the VAT bonds as better than no refund at all, in light of their deep discount, they are not considered to be a satisfactory solution. /A. Lyman

## New Law Creates Unified System for Registering Immovable Property

The existing temporary systems for registering ownership rights to immovable property and mortgages will soon be replaced by a unified registration system, envisaged by the recently enacted Law of Ukraine No. 1952-IV "On the State Registration of Corporeal Rights to Immovable Property and Limitations Thereon," dated July 1, 2004 (the "Registration Law") (see the June 20, 2004 issue of the *CIS & Central Europe Legal Newswire* for a discussion of the interim registration system). The Registration Law entered into force in August 2004, but will become fully operational only when the State Registry of Rights to Immovable Property and Limitations Thereon (the "Registry") begins functioning, currently scheduled for January 1, 2005. The Registration Law effectively merges functions currently carried out under two separate temporary registry systems (*i.e.*, the title registry and the mortgage registry) into a comprehensive cadastral system for registering rights to and limitations on immovable property, as well as unilateral and bilateral contracts regarding immovable property.

### Scope of the Registration Law

The Registration Law provides for the mandatory registration of rights and limitations on the following types of immovable (real) property: (i) land plots; (ii) land plots with buildings and premises (enterprises, farms, workshops, office buildings, *etc.*); and (iii) any buildings, premises or any part thereof (apartments, offices, *etc.*) whose underlying land plot is owned by a different person (as, for example, when the owner of a building leases land from the State).

Under the Registration Law, owners of real property must register their ownership rights with the Registry. In addition, other types of rights to immovable property owned by another person are subject to mandatory registration, such as: (i) rights of possession; (ii) rights of use (such as

easements); (iii) rights to permanent use of a land plot (a usufruct); (iv) rights to use a land plot for agricultural purposes; (v) rights to build on a land plot; and (vi) rights to use immovable property for a term exceeding one year (such as under a lease).

In addition to the mandatory registration of rights to real property, the Registration Law also requires various limitations and encumbrances to be registered. The definition provided in the Registration Law is fairly broad and includes all limitations and restrictions on the ability to dispose of immovable property deriving from a contract, law or act of a state or local governmental body or official. In addition to encumbrances such as real estate mortgages, the Registration Law contemplates limitations such as lease agreements for a term exceeding one year, court decisions and acts of authorized governmental bodies imposing limitations on the disposal of real estate, and any other instance in which a limitation may be imposed on a party's rights to immovable property.

### Main Principles of the Registration System

According to the Registration Law, the registration of a right to or limitation on immovable property constitutes the official (and legal) recognition and approval of the creation, transfer or termination of such right or limitation. Rights and limitations existing when the Registration Law entered into force will continue to be recognized by the State and do not need to be re-registered. The priority established upon initial registration will be maintained.

The Registration Law establishes registration of an ownership right to real property as a precondition to registering any other rights to or limitations on that property. Thus, creditors intending to take out a mortgage on real property will need to ensure that the owner of the property has registered its ownership rights in the Registry before taking out the mortgage.

### Organization of the Registration System

The Registry is designed to function as an integrated informational system containing data on: (i) rights to and limitations on immovable property; (ii) person(s) possessing such rights; (iii) technical characteristics of immovable objects (buildings, premises, *etc.*); (iv) the cadastre plan of land plots; and (v) data on contracts executed with respect to such property. Since the Registry will constitute part of

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the national land cadastre, each immovable object will be identified by the cadastre number of the respective land plot.

Currently, the Ministry of Justice of Ukraine is the central governmental organ responsible for administering both registration systems. Actual registration of titles is carried out by Bureaus of Technical Inventory (communal enterprises), while mortgages are typically registered by notaries or commercial banks. The Registration Law significantly simplifies this process by vesting the State Land Committee of Ukraine (the "Land Committee") with the authority to both administer the cadastral system and maintain the Registry. Registration of real rights and limitations on immovable property will be carried out by the local Land Committee office operating in the registration (cadastre) district where a particular immovable object (or the largest part of that object) is situated.

### Complications

While generally streamlining the legal framework governing immovable property, certain questions arise regarding the Registration Law's interaction with existing laws. For example, according to Chapter 34 of the Land Code of Ukraine (Article 204), which sets out various conceptual provisions concerning the state land cadastre, the procedure for maintaining the cadastre must be specified in a separate law. In setting forth a cadastre-based registration system for immovable property, the Registration Law does not regulate the maintenance of the state land cadastre as a whole, but only establishes a component part. Thus, it is important to note that the functioning of the Registry may depend upon the adoption of an additional law.

In addition, the Registration Law does not appear to accommodate a concept expressed in Law of Ukraine No. 898-IV "On Mortgages," dated June 5, 2003, allowing unfinished construction objects to be mortgaged as immovable property that will exist in the future. The Registration Law provides that registration of a limitation (including a mortgage) depends upon the existence of a previously registered ownership right to that immovable property. However, the Registry is designed to register only physically existing immovable properties that possess all of the legal characteristics of an immovable, meaning that an ownership right to future property may not be registered. This may not pose a problem when the owner of the construction project also owns the underlying land plot, in which case the owner could mortgage the land together with all present and future property affixed to it, including unfinished construction. However, when construction projects are built on leased land plots, the lender may be unable to take a mortgage

on the building until it has been actually completed.

### Conclusions

Once implemented in full, the new system should streamline the process for registering immovable property and provide a stronger legal foundation for protecting the interests of all parties to real estate agreements. This improved legal framework should, in turn, attract investment into Ukraine's real estate sector, to the benefit of state and local budgets. However, in order for these benefits to be realized, the procedure for operating the Registry must be established, and the Registration Law's operation within the existing legal framework must be clarified. /Ya. Gregirchak

## Access to Unified Registry of Immovable Property Transfers Bans Expanded

On August 18, 2004 the Ministry of Justice of Ukraine issued a regulation establishing procedures for operating, maintaining and accessing the Unified Register of Bans on the Transfer of Immovable Properties (the "Register"). Regulation No. 85/5 "On the Unified Register of Bans on the Transfer of Immovable Properties" (the "Regulation"), which came into effect on August 29, 2004, replaces a previous regulation which had been in effect since 1999. Most notably, the new Regulation expands access to the Register, making information on the existence of transfer bans on immovable property directly available to private individuals and companies.

### Concept of Transfer Bans

A ban on the transfer of immovable property is a legal restriction on the object's transfer into the ownership of another party through a sale or other transaction. The purpose of a transfer ban is to protect the interests of persons with respect to either their own immovable property (*e.g.*, for individuals who are not present) or that of a debtor (*e.g.*, for mortgagees or other creditors), in situations where such protection is deemed appropriate.

A transfer ban differs from the related concepts of a charge and a mortgage (security) by specifically preventing a change

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in the property's ownership without the consent of the creditor (or another interested party). In the narrow sense, a charge (which can result either from a security arrangement or other kinds of transactions, such as a sale with a deferred title transfer) is concerned only with regulating priorities among creditors, and as such presents no obstacle to the property's transfer. A mortgage by itself also does not prevent subsequent transfers of the collateral, although a mortgage agreement may provide the basis for a transfer ban if the parties so agree.

### Operation of Transfer Bans

A notary may impose a ban either at the direction of a court or another authorized state agency, in instances provided for by law (e.g., to protect the property of a person declared deceased by a court), or upon notarizing certain transactions involving immovables (e.g., mortgage agreements). The notary makes a relevant note on the instrument underlying the transaction (e.g., a mortgage agreement) and inputs the information about the transfer ban into the Register.

A transfer ban operates on two levels. First, since most transactions involving the transfer of immovables require notarization, a notary is not permitted to notarize a transaction involving an immovable affected by a transfer ban unless the creditor (mortgagee) agrees to the transfer. Second, the absence of transfer bans is a precondition to registering an immovable property's title in the transferee's name.

### Transfer Ban Register

The Register is a central electronic database containing information on bans which have been imposed on the transfer of immovable properties belonging to individuals, companies and other legal entities.

The Regulation designates the Ministry of Justice as the Register's operator, with overall responsibility for its regulation, and the state enterprise "The Information Center" (operated by the Ministry of Justice) as administrator (the "Administrator"), responsible for maintaining, operating and accessing the Register. Notaries (state and private) and state notarial archives ("Registrars") may access the Register under a contract with the Administrator. The main function of Registrars is to process transfer ban applications. Individuals and legal entities ("Users") may also access the Register for personal purposes through a computer network, on the basis of contracts with the Administrator.

Upon application, information from the Register is available

to the general public (individuals or legal entities who are not Users) for a fee. It is not entirely clear whether members of the general public may seek information from the Register only when they enter into notarized transactions or for any reason (e.g., to verify whether the property of a potential debtor (mortgagor) is subject to any transfer bans). Yet it appears from the overall context of the Regulation that any interested individual or legal entity may apply to obtain relevant information from the Register without providing a reason therefor.

The Regulation represents a step forward from its predecessor, by expanding the range of persons permitted to seek information from the Register. While previously such information was provided only to notaries, courts, law enforcement agencies and other specified state agencies, it is now available directly to private individuals and companies. *✓ Fedichin*

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