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# ...Make Legal Due Diligence When Acquiring Industrial Real Estate



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The acquisition of industrial real estate (workshops, warehouses, hangars and office buildings) is an important stage in establishing a foreign investor's fully-fledged business activity in Ukraine. While Ukrainian companies have already privatized the majority of suitable industrial real estate, it seems that the typical way for a foreign investor wishing to acquire real estate is to buy such assets as private property from a private Ukrainian company. As a rule such Ukrainian companies-owners of suitable industrial real estate are organized as Joint Stock Companies or Limited Liability Companies.

The aim of this article is to act as a brief guide for foreign investors who wish to acquire private industrial real estate in Ukraine and to describe the main documents which should be investigated.

So, legal due diligence during the acquisition of real estate generally includes:

I. Analysis of title documents on the real estate. II. Analysis of documents of the seller as a legal entity. III. Resolving the problem of property encumbrances.

## I. Analysis of title documents on the real estate

The main aim is to ensure that the seller of real estate is the real owner:

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all issues connected with title transfer and identity of the true owner must be resolved prior to the conclusion of a sale contract.

Although a system for registering proprietary rights regarding real estate is now "under construction" it does have some lacunas and shortcomings. The new *State Registration of Proprietary Rights on the Real Estate and Their Encumbrances Act of Ukraine* passed by the Ukrainian parliament on 1 July 2004, provides serious reform of the entire system of registration of rights as to real estate and encumbrances belonging to such real estate, though state bodies and databases have still not been created.

The most common title documents, which provide proof of ownership rights of companies to industrial real estate, are: Contracts providing alienation of real estate, e.g. – sale contracts, deeds of a gift, barter contracts, leasing contracts, agreements on the separation of common property; Certificates on the acquisition of mortgaged real estate by public tenders issued by notaries. Deals on the stock exchange as to alienation of real estate under tax lien, which are concluded as the results of special tenders; Court and arbitration decisions on the recognition of property rights; Amicable agreements approved by a Court; Orders on the foundation of state (national) joint stock companies or open joint stock companies created in course of privatization (corporatization) and lists of assets transferred to the statutory capital of such companies; Certificates of Ownership Rights as to Real Estate which were issued by local authorities.

The property rights of a company should be registered in the Real Estate Ownership Rights Register. This Register is the All-Ukrainian ownership rights database. Registration of the title of real estate can be confirmed by an Extract from the Real Estate Ownership Rights Register, distributed by the local Bureau of Technical Inventory. Thus, when buying real estate in Ukraine

you should check title documents and registration of property rights. In order to avoid any legal risks you should also check the title documents of preceding owners and registration of their property rights. Taking into consideration the fact that the majority of industrial buildings in Ukraine were privatized in the last 15 years, alienations should be checked back up till ownership by the state.

## II. Analysis of documents of seller as a legal entity

The main aim of such analysis is to avoid the problem of *ultra vires*, which is a problem regarding the measure of power held by a Ukrainian company official (mainly – director).

The management system of companies in Ukraine consists of the General Meeting of Shareholders, the Board of Directors (an executive body), the Supervisory Board and several other governing bodies.

The Charters of the majority of companies provide that sales of assets (including real estate) for sums exceeding a certain percentage of a company's statutory capital are attributed to the remit of the General Meeting of Shareholders and not to the Executive Body's power. Thus, a meeting of Shareholders should adopt a resolution to sell real estate and complete this in the minutes of shareholders meetings. As we see, a director usually does not have the power to sell a considerable part of the company's assets at his own discretion. However, sometimes directors of companies go beyond the limits of power provided by the Company's Charters and sign voidable contracts on the sale of real estate. Such contracts may be recognized as void by a court due to a claim by an interested party. Such claims are usually made by shareholders of a Company.

The only way to avoid such a possibility is to approve such voidable contract by a decision of the General Meeting of Shareholders. Taking into consideration a number of judicial proceedings initiated by shareholders in order to invalidate sale contracts as to industrial real estate, we recommend to demand a decision by the General Meeting of Shareholders to sell industrial real estate in each case notwithstanding any restriction in the Company's Charter.

Please also note that the *Bankruptcy Act of Ukraine* provides a number of stringent restrictions for directors of companies under bankruptcy proceedings depending on the stage of the bankruptcy proceedings. Thus, at the first stage of the bankruptcy proceeding, the director of a bankrupt company cannot sell assets without the permission of the bankruptcy manager. At this stage a commercial court can pass all directorship powers to the bankruptcy manager by the solicitation of a committee of creditors. At the stage of readjustment, the assets of a company can only be sold by the bankruptcy manager in order to pay the company's debts. The director loses the remaining powers at the stage of a company's liquidation since it is considered to be bankrupt. Thus, to contract with a company in Ukraine you should be sure that there are no bankruptcy proceedings. The beginning of bankruptcy proceedings, consideration of a company as a bankrupt by the court should be accompanied by an official announcement in the *Golos Ukrainy* and *Uriadovoy Kur'yer* newspapers. The best way to find such an announcement is to use the legal database LIGA, Bankruptcy.

So, to avoid the problem of an official's power measures you should check: Charter of seller Company with all the amendments attached; Minutes of meeting of shareholders of the seller company where the director was elected; Minutes of a meeting of shareholders of the seller company which include a resolution to sell real estate; Certificate of state registration of a company; Confirmation from the Uniform State Register of Enterprises, Organizations and Institutions of seller distributed by Bodies of State Statistics; Extract from the legal database LIGA, (see Bankruptcy section) to ensure there are no bankruptcy proceedings; Documents, which contain powers of shareholder's representatives, are also

required.

### III. Resolving the problem of property encumbrances

Generally, Article 659 of the *Civil Code of Ukraine* provides that the seller shall be obliged to warn the buyer about all the rights of the third person in goods being sold (tenant's rights, pledge right, lifelong use right, etc). In the event of violation of this requirement the buyer shall have the right to claim the price reduction or termination of sales contract, unless he was aware and could be aware of the rights of third persons to goods. However, in order to avoid the risk of trials property encumbrances should be investigated directly.

Unfortunately, a general register of all sorts of real estate encumbrances (like the State register of movable property encumbrances) does not exist in Ukraine today. As we said above the appropriate law was passed by Parliament on 1 July 2004 and came into force. However, bodies of state registration and databases have not been created.

Thus, when buying real estate in Ukraine today you should check property encumbrances in such a way.

1. Judicial restraining order as a provisional remedy for a claim. According to the *Code of Civil Procedure* and *Code of Commercial Procedure* courts, commercial courts in Ukraine can carry judicial restraining orders as a provisional remedy for a claim. Thus, it is a normal practice in Ukraine when a court prohibits alienation of a real estate at issue. Such orders are temporary and should be cancelled after the trial is finished, but while they are in force any alienation of real estate will be illegal. There is an Integrated register of restraints on alienation of real estate, supported by the Ministry of Justice in accordance with Regulations approved by the *Order of Ministry of Justice No.31/5 of 9 June 1999*. There, a notary should receive an extract from the Integrated register mentioned above just before the time of conclusion of a sale contract. Such an extract is final evidence of the absence of judicial restraints on alienation of real estate.

2. Contractual mortgage as a security for a credit or loan. There is a procedure for registration of hypothec (as a special kind of mortgage of real estate which is mostly suitable and common), approved by Interim regulations of state registration of hypothecs. All the hypothecs should be registered at the

State register of hypothecs supported by Ministry of Justice in accordance with the Interim regulations on state registration procedure of hypothecs, approved by *Resolution of the Cabinet of Ministers No.410 of 31 March 2004*.

Thus, an extract from register mentioned above confirms the absence of hypothecs. Such an extract should be given to the seller by a notary just prior to conclusion of the contract. However, there is a chance that the real estate mortgage should be not a hypothec. Reasonable mortgages usually demand notaries to restrain alienation of real estate which is mortgaged. Thus, such notaries inscribe assets into the Integrated register of restraints on alienation of real estate supported by the Ministry of Justice (see above). However, there is a theoretical possibility that a mortgage exists (which is not a hypothec) without a restraint on alienation.

3. Tax lien as a security of unpaid taxes. Since there is no special procedure for registration of tax liens, such liens are subject to a procedure for registration of movable property mortgages determined by the *Instruction On the Procedure for Supporting the State Register of Movable Property Encumbrances and Submission of Applications*, approved by the *Order of the Ministry of Justice No. 73/5 of 29 July 2004*. Registration of movable property and real estate tax liens are subject to such a procedure. Therefore, an extract from this register is proof of the absence of the tax lien of movable property and real estate.

4. Servitudes. This is a relatively new legal institute in Ukraine. While there is no general register of all types of real estate encumbrances this means that neither is there a register of real estate servitudes in Ukraine. Information on land servitudes can be received at State Bodies of Land Resources.

5. Lease contracts. According to Article 794 of the *Civil Code of Ukraine*, a lease agreement for a building or any other capital structure or a part thereof concluded for a period of at least a year shall be subject to state registration. After general registration of all types of real estate encumbrances such lease contracts should be registered. Therefore, the only defence for a buyer concerning servitudes and lease contracts is now Article 659 of the *Civil Code of Ukraine*.