

TO: Clients and Friends of the Firm

FR: Frishberg & Partners

RE: Secured Transactions: Pledges, Liens and Encumbrances of Property

## **I. Introduction**

Unfortunately, all too many preventable fraudulent transactions routinely take place in the real estate sector today by employing the inadequacy of the legal and technical infrastructures (i.e., enforcement of laws). In a most basic swindle scheme, an owner uses his real property as collateral to secure a loan from an investor. Later, the same owner sells the real property to a third party and leaves the country without leaving a forwarding address. Amazingly, there is no legal procedure to resolve this common problem.

At the same time, Ukrainian law provides for the classic forms of secured transactions, such as fines, warranties, suretyship, deposit, etc. One of the most effective methods securing a transaction is through the taking of collateral. While secured transactions involving collateral in Ukraine may differ somewhat from the general methods applied elsewhere in the world, transactions secured by collateral in Ukraine allow a creditor to immediately receive the indebtedness owed by a debtor instead of engaging in a lengthy, drawn-out court procedure.

The beginning of 2004 saw the introduction of new legislative acts in the sphere of placing encumbrances on all types of property. In addition to the existing Land Code and Laws “On Collateral” and “On Mortgages”, a new Law No. 1255-IV “On Securing Claims of Creditors and the Registration of Encumbrances,” dated November 18, 2003 (hereinafter “Law No. 1255”), came into effect on January 9, 2004. It regulates legal relations between creditors and debtors by ensuring the fulfillment of obligations involving the pledge of moveable property. Along with the Law “On Mortgages”, Law No. 1255 broadens the provisions of the Law “On Collateral” and divides pledges into two specific types: (i) encumbrance of moveable property and (ii) mortgage of immovable property.

By July of 2004, the Ukrainian lawmakers were busy, developing voluminous legislation in the sphere of encumbrances on property. Firstly, on July 1, 2004, Law No. 1952-IV “On State Registration of In Rem Rights to Immoveable Property and their Encumbrance” was passed and introduced the long-awaited State Register of Rights to Immoveable Property and their Encumbrance. At the end of July, the Ministry of Justice passed Order No. 73/5 “On Approval of

the Instructions on the Procedure for Maintaining the State Register of Encumbrances to Moveable Property and Filling Out Applications,” dated July 29, 2004.

Upon implementation of the above laws, vocal complaints began to pour in about the new registers, and in particular, about the registration authorities themselves and their arbitrary decisions. While the above-mentioned registers are still not ideally functional, Ukraine is well on its way to introducing a legal system whereby one may verify the existence of liens and encumbrances on all types of property.

Below we provide an analysis of this area of Ukrainian legislation which, of course, still requires improvement.

## **II. The Law “On Collateral”**

The Law “On Collateral,” No. 2654-XII, dated October 2, 1992, as lastly amended on September 6, 2005, generously allows the use of various types of property as security to guarantee parties’ obligations with respect to existing or future claims, in particular claims which arise from loan agreements, sale-purchase agreements, lease agreements, shipment transfer agreements, etc.

The Law “On Collateral” simply states that in the event a debtor breaches its obligations, its creditor has the right to seek satisfaction by disposing of such debtor’s secured property. As in the more developed countries, the secured creditor takes precedence over any unsecured creditors in bankruptcy proceedings.

Most forms of property may serve as security, including personal and real property, property rights, production results, etc. Transactions involving foreign investors are usually sufficiently large enough to require real property to serve as security. Therefore, we will describe the use of real property as collateral, and the procedure for transferring such property to the creditor in case the debtor fails to fulfill its obligations.

### **A. Real Property**

Generally, any party with real property rights, including legal entities and individuals, may use its land and any construction thereon as security for an underlying obligation. Apartments, unfinished construction buildings and whole industrial enterprises, both private and state-owned (unless undergoing the process of corporatization or the law prohibits their privatization) theoretically may be pledged as security under Ukrainian law. Further, by obtaining security rights in freestanding buildings, the creditor also obtains the right to use the land thereunder if such creditor becomes the property owner.

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