

# Devaluation of Russian Currency as a Ground for Rent review?

On 29 March 2016 the Ninth Arbitrazh Appellate Court (case No. A40-83845/2015) reversed the earlier decision of the Moscow City Arbitrazh Court which took the unprecedented step of introducing a currency band of RUB 30-42 per USD 1 for rent amounts under an office lease agreement. The band was introduced in the middle of a ten-year lease entered into between two commercial parties (the "**VimpelCom Case**").

## Background for the dispute

In 2009 PJSC Vimpel-Communications ("**VimpelCom**") entered into a ten-year lease agreement in respect of premises exceeding 30,000 sq. m in a class A+ business complex in the centre of Moscow (the "**Lease**").

As with most of class A commercial buildings in Moscow, the rent payments due under the Lease were denominated in US dollars. However, given that Russian law requires settlements between two Russian companies be made in Russian roubles, the Lease stated that the rent payments were to be made in Russian roubles based on the official RUB/USD exchange rate published by the Russian Central Bank.

## The tenant's position

In 2015 VimpelCom sued the landlord seeking to terminate or amend the Lease on the ground that the rent due under the Lease significantly increased compared to previous years as a result of adverse movements in the Russian currency.

The tenant claimed that it agreed to the denomination of rent in US dollars taking into account the financial and economic situation that existed at the time of negotiating the terms of the Lease, including:

- the relatively insignificant exchange fluctuations of the Russian rouble; and
- at that time the currency policy adopted by the Russian Central Bank was based on the managed float regime. This meant that (i) the official exchange rate was determined within the limits of the "*currency corridor*"

established by the Russian Central Bank; and (ii) the Russian Central Bank exercised "*currency interventions*" if the exchange rate reached or exceeded the limits of the currency corridor. The tenant claimed that such measures enabled it to predict to a certain extent the rent amounts and rely on the overall predictability of the economic situation.

On 10 November 2014 the Russian Central Bank abandoned the managed float regime and switched to a free floating regime. As a result, in December 2014 the RUB/USD exchange rate increased by 2.5 times the prevailing rate when the parties negotiated the terms of the Lease. The economic sanctions imposed on Russia further weakened the Russian rouble.

The tenant additionally claimed that the change in currency policy and economic sanctions against Russia constituted a so-called "*material change of circumstances*".

## What is material change of circumstances?

An agreement can be terminated or amended by a court in case of a material change of circumstances which the parties relied upon when deciding to proceed with the transaction. In order to invoke the material change of circumstances, it needs to be proved that:

- at the time of entering into the agreement, the parties proceeded on the basis that no such change will take place;
- the change of the circumstances was caused by factors which the interested party could not overcome;

- the execution of the agreement without amending its provisions would entail such a loss for the interested party that it would have been deprived of what it could have counted upon when entering into the agreement; and
- the agreement did not set out that the risk arising from such change of circumstances must be borne by the interested party.

A material change of circumstances is not the same as *force majeure*, although these concepts are alike. The legal effect of a *force majeure* event is that a defaulting party can be released from liability for breach of its obligations if the breach was caused by such event, whereas a material change of circumstances does not release a party from liability for performing its obligations, but instead enables it to terminate or amend the agreement in court.

### Sanctions and change in national currency policy do not qualify as a material change of circumstances

Both courts rejected the tenant's argument that the Lease should be terminated due to the material change of circumstances, i.e. the depreciation of the national currency due to the change in the official currency policy and sanctions imposed on Russia. The courts stated that the currency fluctuations could, and should, have been foreseen by the parties.

This approach is consistent with Russian court practice established since the 1998 financial crisis, during which courts formed the view that a fall in the national currency is not a material change of circumstances.

### Why did the first-instance court introduce the currency band?

Despite the above arguments, the first-instance court upheld the tenant's claim and amended the Lease by setting out RUB 30 per USD 1 as a minimum exchange rate and RUB 42 per USD 1 as a maximum exchange rate for rent payments (i.e., it imposed a "*rent corridor*").

The minimum limit was consistent with the official RUB/USD exchange rate set out at the time of entering into the Lease (RUB 31.5 per USD 1).

The first-instance court gave the following reasons:

- Under the Russian Civil Code, **no one can benefit from its illegal or unfair behaviour**. When considering whether or not the landlord acted in bad

faith, the court referred to the Decree of the Plenum of the Supreme Arbitrazh Court "On Freedom of Contract and its Limits" (the "**Decree**"). The Decree states that the good faith of a party should be determined based on the behaviour expected from any party to a business transaction and that it must be cooperative and should take into account the rights and legitimate interests of the counterparty. In the event the court identifies that a party acted in bad faith, it can take measures which would protect the interests of the non-defaulting party.

- The first-instance court took into account the fact that the landlord did not suggest any counter-proposals during the court proceedings in respect of the currency conversion. Given the economic climate, the owners of office complexes and shopping centres in Moscow frequently received requests from their tenants on rent discounts. Some of the landlords made concessions and agreed on a discount/rent reduction. Thus, in the VimpelCom Case the lack of any proposals from the landlord was implicitly considered by the first-instance court as bad faith behaviour of the landlord.
- The court also took into consideration the expert opinions showing that the rent under the Lease exceeded the average market rent payable for similar premises in the same area. The court stated that the significant excess of the contractual rent over the market rates could lead to "**potential unjust enrichment**".
- Further, the court ruled that the introduction of a currency band **did not change the contractual provision concerning the rent amount**, because the rent rates set out in the Lease remained the same. The court ruled that the introduction of the currency band was required to maintain the balance of the legitimate interests of the parties.

### The position of the appellate court

The appellate court reversed the decision of the first-instance court on the following basis:

- The first-instance court did not specify which of the landlord's actions were undertaken in bad faith. The appellate court pointed out that the landlord was simply requiring the performance by the tenant of its obligations under the Lease as was contractually agreed between the parties.
- The refusal of the landlord to re-negotiate the rent did not mean that the landlord was abusing its rights. Moreover, the possibility to denominate the rent in a

foreign currency is expressly permitted by the Russian Civil Code.

- The concept of unjust enrichment relates to non-contractual relations and, therefore, cannot be applied to the contractual relationships of parties based on a lease agreement.
- The court at first-instance amended the Lease, although it did not have authority to do so. In particular, pursuant to clause 450 of the Russian Civil Code, an agreement can be terminated or amended by a court upon request of one party:
  - in the event of a material breach by the other party of its obligations; or
  - in other events provided for by law, the Russian Civil Code or the agreement itself.

The court found there was no material breach of the obligations on the part of the landlord. Further, the Lease itself did not provide for the possibility to amend the Lease in court in the event that the parties were unable to resolve a dispute in relation to the rent revision.

On the whole, the appellate court decision was predictable and not surprising given the weak and contradictory arguments of the first-instance court. If left to stand, the first-instance court decision would have undermined the overall certainty and binding effect of contractual agreements between commercial parties negotiating on an arms-length basis. Its impact may have also been felt well beyond the Russian real estate market. However, this may not be the end of this saga as it is expected that the decision of the Ninth Arbitrazh Appellate Court will be appealed.

*Pacta sunt servanda.*

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