

THE IMPACT OF CORONAVIRUS ON CONTRACTUAL RELATIONS FROM A RUSSIAN LAW PERSPECTIVE

The Coronavirus (COVID-19) pandemic has prompted unprecedented measures by many countries. International and domestic travel have been significantly curtailed. Restrictions have been imposed on various types of business (the "**Government Measures**").

Many companies and entrepreneurs are facing difficulties fulfilling their obligations, whether under supply contracts, works contracts, loans, leases or rental agreements.

Questions inevitably arise as to whether the Pandemic and the Government Measures constitute grounds for termination or modification of obligations and/or release from liability for default.

In this briefing we analyse the potential impact of the Pandemic and the Government Measures on contractual relations from the standpoint of Russian law¹. We will also cover certain recent statutory acts that directly affect the rights and obligations of parties to contractual relationships.

OVERVIEW OF LEGAL GROUNDS

From a Russian law perspective, the Pandemic and the Government Measures can be considered in the following contexts:

- Debtors generally can be released from liability for failure to perform/delay in performing obligations (but not exempted from the obligation itself) due to force majeure (the Civil Code of the Russian Federation (the "**Civil Code**")), Article 401);
- If a creditor has lost interest in performance of an obligation as a result of delay by the debtor due to force majeure, the creditor can, as a general rule, demand termination of the contract (Decree of the Plenum of the RF Supreme Court No. 7 dated 24 March 2016, para. 9);
- Where it is permanently impossible for a debtor to perform an obligation due to force majeure, this may be grounds for termination of the obligation (Civil Code, Arts. 416, 417);

Key points:

- The COVID-19 pandemic and the Government Measures may have a significant impact on contractual relations between counterparties.
- They may be considered in the context of (1) release from liability for default; (2) potential termination of contract by creditors due to loss of interest on their part; (3) termination of obligations; and (4) amendment of contract due to a material change in circumstances.
- In each specific case, the provisions of the contract must be taken into account. It may specify or expressly exclude grounds for release from liability for default or for amendment/termination of the contract.
- Government authorities are taking steps to support certain sectors of the economy. In particular, the State Duma has passed laws on rent and loan payment holidays which contain provisions that are obligatory for landlords and lenders.

¹ See our other materials on the impact of COVID-19 on various business sectors: https://www.cliffordchance.com/insights/thought_leadership/coronavirus.html.

- Finally, a material change in circumstances may be grounds for amendment or termination of the contract (Civil Code, Article 451).

The provisions of the contract are important, because in them the parties can specify additional grounds for release from liability for default on their obligations or for amendment/termination of their obligations, or, conversely, they can exclude any grounds (e.g., application of Article 451 of the Civil Code).

Furthermore, as mentioned above, certain laws have been passed that directly affect the rights and obligations of parties to contractual relationships in specific areas (to date, for example, real estate leasing and bank lending).

Release from liability for default due to force majeure

Under Article 401 of the Civil Code, a debtor can be released from liability for defaulting on an obligation if due performance was impossible as a result of force majeure. However, the availability of this exemption is contingent upon the presence of a 'triad' of factors: exceptionality, unavoidability and insuperability.

The Pandemic and the Government Measures can in principle be classified as force majeure. The Russian authorities also share this position².

However, the following must be taken into account:

- The Pandemic and the Government Measures do not in themselves mean there are grounds for exclusion of liability under Article 401 of the Civil Code; in each particular case it must be analysed whether performance of the obligation has been rendered impossible by force majeure or not, and also how the parties to the contract have apportioned the risk of force majeure;
- A force majeure event in itself only releases a party from liability for failure to perform the obligation, but does not exempt that party from the duty to perform it. For example, if it is not possible for a debtor to fulfil an obligation to supply, then generally it is exempt from penalties / the duty to compensate losses due to late delivery, but not from the obligation itself. Contracts sometimes contain clauses stating that if a force majeure event persists for a certain period of time, the parties (both or either one) can terminate the contract (see also the section below on repudiation of contract);
- Breach of obligation by a debtor (e.g., to supply equipment) due to a breach by its counterparty (e.g., a supplier of components for the equipment) is generally not considered force majeure³;

However, if the default by the debtor's counterparty has been caused by force majeure, then it becomes less clear whether there are grounds for release from liability in the debtor-creditor relationship or not. For example, in a number of cases the Russian courts have followed the Vienna Convention⁴, which in such situations exempts the debtor from liability to the creditor⁵;

- In case of force majeure, the debtor generally must notify the creditor immediately of the onset of the event. Should the debtor fail to do so, it may be obliged to reimburse losses incurred by the creditor due to the latter's lack of information about the force majeure event. However, since the Pandemic and the Government Measures are common knowledge, the courts' findings as to the consequences of failure to notify may vary from case to case (e.g., notification may be deemed more important when the failure to notify is due to a breach of obligation by a counterparty of the debtor which is located abroad).
- The statutory provisions on force majeure are dispositive, so certain circumstances can be excluded by agreement of the parties (or, conversely, included in the contract). Therefore, the provisions of the contract between creditor and debtor must be analysed in each case.

² See, for example, Edict of the Mayor of Moscow No. 12-UM of 5 March 2020 (as amended on 29 March 2020), which states *"the spread of the new coronavirus infection (2019-NCov) in the current circumstances is an exceptional and unavoidable situation requiring a state of high alert... which is a force majeure event"*.

³ Article 401(3) of the Civil Code: "[Force majeure] does not include breach of obligations by a debtor's counterparties". See also paragraph 3 of Decree of the Plenum of the Supreme Court of the RF No. 7 dated 24 March 2016.

⁴ United Nations Convention on Contracts for the International Sale of Goods, 11 April 1980.

⁵ See, for example, Decrees of the Arbitrazh Court of the Moscow District dated 24 October 2018 in case No. A41-73316/2017 and dated 15 June 2018 in case No. A40-70413/2017.

Generally speaking, the courts have tended to take a rather conservative approach to exclusion of liability based on Article 401 of the Civil Code. But now, in light of the unprecedented nature of the situation and the Government Measures that have been taken (or are in the process of being taken), there may be a shift in the position of the courts (for details of specific measures, see the section below entitled *Government Measures that directly affect the rights and obligations of parties to contractual relationships in certain sectors of the economy*).

Repudiation of contract by creditor due to temporary impossibility of performance by debtor on account of force majeure

Articles 401(3) and 405(2) of the Civil Code allow a creditor to repudiate a contract (and also, for example, to require the return of an advance payment) in circumstances where force majeure causes a delay by the debtor under the contract and the creditor loses interest in its performance. In case of such repudiation the creditor cannot recover penalties or losses from the debtor⁶.

However, it may well be the case that in each particular situation the courts will scrutinise whether the interest in performance was indeed lost and whether the creditor's repudiation of the contract was in good faith.

Impossibility of performance of an obligation by a debtor due to force majeure may be grounds for termination of the obligation

Within the meaning of Articles 416 and 417 of the Civil Code, if the impossibility of performance arising as a result of force majeure is not temporary but permanent, the debtor is not only exempted from liability for failure to perform the obligation, but also from the obligation itself (both the debtor's obligation and the creditor's counter-obligation) terminates⁷. Crucially, performance must be impossible, not just difficult.

If performance has already been effectuated by the creditor, it must be returned (otherwise there may be unjust enrichment on the part of the debtor)⁸. However, this may be impossible in practice in light of the potential risk of bankruptcy of the debtor.

Amendment of contract in connection with a material change in circumstances

The Pandemic and the Government Measures could conceivably be considered in the context of Article 451 of the Civil Code. If Article 401 of the Civil Code provides that a force majeure event renders performance of an obligation impossible, Article 451 of the Civil Code envisages the following:

- it is still possible for the debtor to perform the obligation, but performance will cause significant damage to the debtor;
- the damage is attributable to factors that are (i) objective (i.e., beyond the control of the parties to the contract) and (ii) did not exist and could not be foreseen on the date the contract was concluded;
- application of Article 451 of the Civil Code may result in termination or amendment of the contract by the courts. Under this variant it is possible that the debtor may not only be released from liability for failure to perform the obligation (as under Article 401 of the Civil Code), but also fully or partially exempted from the obligation itself.

The courts tend to be rather conservative in their approach to possible amendment or termination of contracts in connection with a material change in circumstances. However, the impact of the Pandemic and the Government Measures on each particular legal relationship must be considered, and it is not inconceivable that the courts could apply Article 451 of the Civil Code to any legal relationship. It may that Article 451 of the Civil Code is less likely be applied to long-term contracts than short-term contracts, to contracts with entrepreneurs than contracts with individuals who are not entrepreneurs.

⁶See also para. 9 of Decree of the Plenum of the Supreme Court of the RF No. 7 dated 24 March 2016.

⁷ *Ibid.*

⁸ See, *inter alia*, Ruling of the Supreme Court of the RF No. 307-ES14-4892 dated 28 November 2014 in the case No. A56-72070/2013, Ruling of the Supreme Arbitrazh Court of the RF No. VAS-16456/12 dated 20 December 2012 in case No. A41-25957/10, Decree of the Arbitrazh Court of the Moscow District dated 1 December 2016 in case No. A40-4581/2015, Decree of the Arbitrazh Court of the Moscow District dated 2 December 2016 in case No. A40-208591/2015.

At the same time, it should be noted that parties can contractually exclude the application of Article 451 of the Civil Code.

Government Measures that directly affect the rights and obligations of parties to contractual relationships in certain sectors of the economy

- The Law On the Incorporation of Amendments to Certain Legislative Acts of the Russian Federation for the Prevention and Liquidation of Emergency Situations was passed on 1 April 2020, putting in place a series of measures, including rent payment holidays.

The law stipulates that tenants (not only those leasing state property) have the right to require that rent payments under lease agreements be deferred. Within 30 days after receiving such a request from a tenant of the relevant real estate, the landlord must enter into a supplemental agreement deferring the rent in 2020. The law also stipulates that the terms and conditions of such deferrals are to be established by the Government of the Russian Federation. At present, there is no such act.

Also, the law provides that tenants are entitled to demand a reduction of the rent if it becomes impossible to use property due to a decision to impose a high-alert regime, taken by a government authority of a constituent entity of the Russian Federation.

- On 1 April 2020, the State Duma also passed the Law On the Incorporation of Amendments to the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) and Certain Legislative Acts of the Russian Federation. This law has yet to be signed by the Russian President but it will provide, amongst other things, loan payment holidays. Small and medium businesses, private individuals and individual entrepreneurs have been granted the right during the term of a credit facility (loan agreement) to require the lender to defer the payments, but only for a maximum of six months.

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