With many western firms unwinding years of Russian contracts and investments, we assess how businesses can manage the risks.

In the light of Russia's invasion of Ukraine, companies worldwide have announced that they are withdrawing from Russia. Unwinding years of legal relationships is complex and may involve risks of liability as well as potential claims. This article explores some of the principal considerations in relation to terminating Russia-related commercial contracts. It also highlights how investment treaties may offer an avenue for recourse if investments in Ukraine or Russia are affected by Russian state action.

**RUSSIA’S INVASION OF UKRAINE: PART 1: IMPLICATIONS FOR COMMERCIAL CONTRACTS**

When Russia invaded Ukraine in February 2022, the international reaction against Russia was swift and significant. At the governmental level, many countries moved very quickly to impose sanctions packages aiming to cut the flow of foreign capital into Russia. Russia responded by passing a range of new laws, often referred to as 'counter-sanctions'.

Practically all international companies with operations in the region have been affected. Primary concerns have included ensuring the safety and well-being of employees on the ground and/or directly impacted by the invasion, ensuring compliance with the new international sanctions and monitoring the evolving Russian legislation. And many companies have taken decisions to bring their Russian operations to an end, or are still considering their position.
Any decision to end or to scale back operations in Russia will of course require careful consideration of the contractual rights and obligations of the parties. If a party gives notice that it intends to terminate a contract in the absence of a clear contractual right, it risks a complex and expensive legal dispute and potentially significant liability. Many commercial contracts do not contain rights to terminate contracts at will, and therefore a party wishing to bring a Russia-related contract to an end may need to invoke other provisions in the contract such as a force majeure or material adverse change ("MAC") clause, or to have resort to other legal doctrines such as the doctrine of frustration.

We consider these points further below.

**FORCE MAJEURE CLAUSES: "PREVENT" AND "HINDER" ARE NOT THE SAME THING**

The legal systems of many countries with a civil code, including Russia, recognise a doctrine of force majeure which operates in circumstances where performance of the contract is prevented, delayed or hindered by circumstances outside the reasonable control of the parties.

However, under English law, the availability of force majeure depends on whether it is expressly included in the relevant contract, and upon the precise terms of the relevant clause.

Force majeure clauses commonly refer to a list of circumstances or events, including an outbreak of war or the passing of new legislation, not foreseen by the parties at the time of entering into the contract, which have rendered performance of obligations under the contract impossible (or significantly more difficult).

The precise wording of such a clause is very important. For example, some force majeure clauses are worded as the unforeseen event having to "prevent" performance of the contract, whereas others use the language of "hinder" or "delay". If a clause requires the force majeure event to prevent performance, this generally means that the clause can only be invoked if it is physically or legally impossible for the party invoking the clause to perform its obligations. This is a high standard to meet. On the other hand, when the words "hinder" or "delay" are used, contractual performance would generally need to be substantially more difficult (even if not impossible). There is a large body of English case law on this distinction.

Many force majeure clauses contain an express mitigation requirement, and in any case the English courts have implied into force majeure clauses that the party seeking to rely on it has to take reasonable steps to mitigate against the effects of the relevant circumstances or event. For example, where a party seeks to rely on sanctions as the force majeure event, it should first explore whether a licence is available or other manner of lawfully complying with the contract.

Some contracts may contain a stated right of termination where circumstances constituting force majeure persist for a specified period of time. This right may only be exercisable by the party that has not declared the force majeure, or by either party. Where there is no such provision, there is no automatic termination right.
Clearly the value of a force majeure clause depends on its terms and the circumstances in which it can be applied. It may not assist where a company makes a policy decision that it no longer wishes to continue a Russia-related contract. However, for companies directly impacted by the war in Ukraine, sanctions against Russia, or new Russian legislation, the scope of any force majeure clause should be closely considered.

“The application of force majeure clauses to any particular circumstances is rarely clear-cut and disputes can often arise. For example, a significant number of cases arising from the Covid-19 pandemic are currently being litigated or arbitrated.”
ANDREW CANNON

MAC CLAUSES

Material Adverse Change (MAC) clauses are typically found in finance agreements and M&A transactions, but may also be used in other contracts as a risk allocation tool. They often permit a party to terminate a contract but, if triggered, may have other consequences, such as acceleration of contractual obligations. The relevance of a MAC clause in the context of the invasion, the sanctions or Russia's reaction to the international response, will be determined by its terms. The English court has generally required a high threshold to be reached before finding that a material change has occurred.

DOCTRINE OF FRUSTRATION

The doctrine of frustration may also be relevant. The doctrine may apply if it can be shown that performance has become impossible or illegal in unforeseen circumstances, or when the performance has become radically different from that which was agreed, and where there is no contractual provision (such as force majeure) which provides for such an event. It follows that in circumstances where a Russian counterparty is sanctioned, a terminating party may be able to avail itself of the doctrine of frustration to bring the contract to an end and discharge any further obligations under it.

The courts apply the doctrine strictly, considering whether there is anything the party claiming frustration could have done to avoid the frustrating event (such as seeking a licence), as well as whether that event affects the whole of the contract or only certain obligations and the degree of permanence of those circumstances.

Difficulties in performance that arise from consequences of the invasion – rather than the sanctions themselves – depending on their severity may not be regarded as of sufficient permanence to establish the contract is frustrated. An example would be the impact on supply chains.

In all of these situations, the law under which any claimed illegality arises should also be carefully considered. As a matter of English law, performance may only be excused where it is illegal under the governing law of the contract or in the place of performance.
Some practical considerations

- **Compile a list** of all relevant commercial contracts potentially affected.
- **Review the terms of each contract** to evaluate your options, including the wording of any force majeure or MAC clauses, any sanctions-related representations and warranties, and the scope of any express termination rights.
- **Collate evidence** of the impact of the Russian invasion on operations and any steps taken to avoid or mitigate the impact.
- Seek to **maximise privilege protection** in respect of discussions of termination rights and avoid creating unhelpful documents which may be disclosable in subsequent legal proceedings.
- **Assess options for negotiating a commercial solution** with counterparties, mindful of any constraints imposed by sanctions.
- **Ensure a clear right exists to terminate** any contract before doing so, to minimise the risk of a repudiatory breach.
- Check the dispute resolution options and be ready to **arbitrate or litigate any dispute** arising out of termination.
- Check for relevant **developments of Russian law**, for example, under a recent decision, Russian courts may take jurisdiction to hear disputes involving Russian-sanctioned individuals and entities as well as entities controlled by them.
- Throughout the process, **keep sanctions developments under review**, as these change rapidly. Consider not only the sanctions regime of the country where you are based, but also other key regimes given the risk of secondary sanctions. You can subscribe to HSF's Sanctions Tracker for reports on key developments.

INVESTMENT TREATY PROTECTIONS AND POTENTIAL CLAIMS AGAINST RUSSIA

Companies whose operations in Ukraine, Russia or elsewhere have been adversely affected by Russia's conduct will be considering whether there are ways to either recover or mitigate their losses. Bilateral investment treaties (BITs) may present an opportunity for recourse.

BITs are agreements between two or more countries (states) containing reciprocal undertakings for the promotion and protection of private investments made by nationals of the state signatories in each other's territories. Such agreements have historically been agreed to provide confidence to foreign investors that their investment will not be negatively affected by irregular action by the state hosting the investment and, if it is, to enable the investor to claim damages through an independent arbitral process rather than only in the host state's own courts.

Each treaty must be considered on its terms, but BITs commonly include: protection against unlawful expropriation of an investment without adequate compensation; a guarantee of fair and equitable treatment; a guarantee of full protection and security for the investment and investor; and the right to repatriate profit and capital. BITs may also include war clauses guaranteeing compensation for losses owing to an armed conflict.
As well as Ukraine, Russia has entered into BITs with major economies including the UK, UAE and Japan. Many of Russia's BITs seek to place limits on an investor's ability to pursue a dispute through arbitration but some tribunals have nevertheless considered themselves able to take jurisdiction.

A number of claims were initiated against Russia under the Ukraine-Russia BIT following Russia's invasion and annexation of Crimea. Tribunals found that investments in Crimea prior to its annexation were protected under the Ukraine-Russia BIT by virtue of the fact that Russia was in *de facto* control of the territory in Ukraine in which the investments had been made.

There are also a number of jurisdictional requirements that must be satisfied in order to successfully bring a claim, and these will depend upon a careful review of the nature of the investment and investor in light of the wording of the BIT.

Companies with operations or investments in Russia may be concerned at the prospect of retaliatory measures by Russia, such as counter-sanctions, seizure of shares or immovable property or the blocking of access to funds. Accordingly, they should consider their corporate structures and potential protections offered by any relevant Russian BITs against such measures.

**OSCHADBANK V RUSSIA**

This case was brought against Russia by a Ukrainian state-owned bank following Russia's invasion of Crimea. Oschadbank operated a number of branches in Crimea and claimed that the banking regulations imposed by Russia in Crimea after its invasion resulted in an unlawful expropriation of its investment in violation of the Ukraine-Russia BIT. Oschadbank won a US$1.1 billion award in the arbitration, with the tribunal upholding its jurisdiction, although the Paris Court of Appeal (the court of the seat of the arbitration where a challenge to the award was brought) later ruled that the BIT in question did not protect investments made prior to 1992.

Russia has generally chosen not to participate in treaty arbitrations arising from its invasions of Crimea and Georgia and, when it has, it has participated only by sending a letter challenging jurisdiction or at the quantum stage. However, Russia has typically become highly active in challenging the awards of the tribunals in the local courts of the seat and resisting enforcement. As the sanctions regime is broad and complex, enforcement strategy should be considered at the outset of any claim.

**CONCLUSION**

Businesses with operations in Russia or Ukraine are facing difficult decisions. Terminating contracts with Russian counterparties for operational or reputational reasons or pursuing relief for lost or damaged investments carry significant risks and require careful consideration. Ultimately, these risks can be managed but there are few easy answers.
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