

COVID-19: PRESSURE POINTS: CIVIL LAW QUALIFICATION AND CONSEQUENCES FOR CONTRACTUAL RELATIONS UNDER RUSSIAN LAW

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Legal Briefings - By **Artjom Buligin, Danil Guryanov, Maria Dolotova**

Notwithstanding its detrimental impact on both the public health and the global economy, the increasingly global prevalence of the novel coronavirus (which causes the disease known as “COVID-19”) has less obvious and straightforward legal consequences for market participants.

Only a few weeks ago, the global spread of COVID-19 was far from the forefront of Russia’s public, political and economic conscience; few people, including representatives of the country’s main political and financial institutions, had expressed serious concerns about the virus. However, an increase in the incidence rate of COVID-19 in Russia, combined with the introduction of a high-alert regime in Moscow¹ (which has since been implemented across almost all of Russia²) and the closure of most official institutions, has contributed to the heightened tension which has developed in Russia recently around this issue.

These evolving circumstances, in turn, also affect the execution of contracts and the implementation of other kinds of commercial arrangements between parties. In some cases, counterparties may reasonably require the amendment of previously executed agreements. It is also possible that, in light of the impact of COVID-19, performance of some of the counterparties’ obligations under the relevant agreements has (or may) become impracticable or unduly onerous. From the counterparty perspective, therefore, it is also important to understand how such agreements can be amended or terminated where the applicable circumstances arise and/or legal conditions are met.

In this regard, evaluation of the legal consequences of COVID-19 on contractual arrangements under Russian law has become necessary given the relevance of the abovementioned issues to contract counterparties.

SUMMARY

The circumstances surrounding the spread of COVID-19 create a significant risk of inability of commercial parties to meet their contractual obligations. Russian law provides a number of remedies available to both the defaulting party (in a situation where the breach of contract is caused by circumstances beyond the defaulting party's control) and the innocent party.

The remedies available to the defaulting party include (1) force majeure (by virtue of law or contract); and (2) termination of an obligation due to the impossibility (legal or actual) of its performance. The innocent party may have a right to walk away from the contract if the other party has breached the contract in the current situation of spread of COVID-19 or to unilaterally change the terms of the contract (provided that there is an express term in the contract allowing this). Both parties may apply to court to amend or terminate the contract due to a significant change in circumstances. When using all of these remedies, the parties must act in good faith and reasonably.

As described in more detail below, the spread of COVID-19 and the restrictive measures introduced in connection with it are classified by the Decree of the Mayor of Moscow as force majeure. Epidemics and mass diseases are also classified as force majeure by the Russian CCI. However, the parties should keep in mind that only the courts are authorised to determine that force majeure has occurred in the particular circumstances. Decrees of state bodies and CCI certificates of force majeure do not bind the courts to find that force majeure has occurred in any given case.

The fact of the occurrence of force majeure is only one element which the defaulting party must prove in order to be released from liability for breach of its obligations.

The party in breach of the contract for non-performance (improper performance) of its obligations due to force majeure must also prove that the circumstances to which it refers are extraordinary and unavoidable, as well as the existence of a causal relationship between these circumstances and the inability to perform under contract.

STATUS OF COVID-19 IN RUSSIA

On 11 March 2020 the Director-General of the World Health Organisation (“**WHO**”) announced that spread of COVID-19 is to be categorised as a global pandemic.

The declaration of COVID-19 as a pandemic does not affect the conclusions of the risk analysis initially published by the WHO and so the recommendations it previously issued to its members (of which Russia is one) in respect of the implementation of various measures aimed at containing spread of COVID-19 stand unchanged³. This declaration only emphasised once more the urgency and scale of the problem and the level of response which is required of all countries.

In Russia, the spread of COVID-19 drew the attention of public authorities in early March this year.

On 5 March, under the Decree of the Mayor of Moscow, a high-alert regime within the territory of the capital city was introduced. The Decree of the Mayor of Moscow (as amended) acknowledges that the spread of COVID-19 is an extraordinary and unavoidable event, which has necessitated the introduction of a high-alert regime, with such measure being a “circumstance of insuperable force”.

On 17 March the Russian Government and the Central Bank issued a joint statement⁴ on the measures to support the economy and mitigate the consequences of COVID-19. The measures include deferment for the collection of taxes to be paid by the most adversely affected business sectors, provision of short-term facilities to entrepreneurs on favourable terms, and the introduction of a moratorium on filing bankruptcy applications in respect of legal entities whose obligations to the budget⁴ are due.

At present, the Russian Government is considering whether to discharge from liability those legal entities that are parties to state procurement contracts, who have breached their obligations thereunder due to the effects of COVID-19⁵ (under the law No. 44-FZ). Force majeure is being discussed as a legal concept for this purpose.

As such, the outcome of governmental regulatory discussions on these issues raises the following legal uncertainties: will the spread of COVID-19 be regarded under Russian law as a circumstance of insuperable force for the purposes of contractual relations? What are the possible alternatives for categorising such an event?

COVID-19 AS A CIRCUMSTANCE OF INSUPERABLE FORCE (FORCE MAJEURE)

Force majeure by virtue of law

Force majeure, or a circumstance of insuperable force, is defined by⁷

- Unavoidability (it being objectively impossible for any market participant to avoid such a circumstance or its consequences),

- Extraordinariness (the exceptionality of the event in question, which occurrence is not usual in the relevant circumstances).

This definition is also often supplemented by the criterion of "insuperability", which implies that due to the objectively unavoidable nature of the force majeure event it would be unreasonable⁸ to require the defaulting party to take measures to overcome it because, for example, the event was beyond the defaulting party's control⁹.

It should be noted that neither Russian law nor the Russian courts will give effect to so-called entrepreneurial risks as a force majeure event, including economic and financial crisis, delay or bankruptcy of the counterparty, devaluation of the national currency etc., unless such events and circumstances are otherwise specified in the contract.

Force majeure by virtue of contract

Russian law permits counterparties to designate in the contract itself a list of events and/or circumstances, the occurrence of which could be grounds for releasing each party from liability for breach of the contract (or otherwise change the grounds for liability of the parties). In other words, the parties are entitled to include circumstances which are not considered to be force majeure events by virtue of Russian law in their contracts which, if they occur, will operate to exclude the defaulting party from liability to the non-defaulting party for any breach of the contract relating to those circumstances (for example, relating to the category of entrepreneurial risks).

COVID-19 as a force majeure circumstance

On the basis of the above, it is likely that the proliferation of COVID-19 infections in Russia and the Government's subsequent adoption of a high alert regime, as well as other restrictions, may be caught within the legal definition of the force majeure circumstances established under Russian law. If not, epidemics and prohibitive measures of certain states or governmental bodies and other circumstances beyond the control of the parties are often explicitly set out in the contractual provisions as grounds for releasing the party in breach from liability for non-performance of its obligations.

The Regulation of the Russian CCI on the procedure for certifying force majeure circumstances also includes mass diseases (epidemics) in its list of force majeure circumstances, along with natural disasters (e.g. earthquake, flood, hurricane), fire, strikes, military actions, terrorist acts, subversion, prohibitive measures of states and other circumstances beyond the control of the parties to the contract.

Confirmation of force majeure

Establishing that COVID-19 falls within the legal or contractual definition of a force majeure event will not automatically release the defaulting party from liability under the contract. The party in breach of the contract for non-performance (improper performance) of its obligations by law or contract, must prove:

- the facts relating to the occurrence of the force majeure event itself;
- that the circumstances which the party in breach claims to constitute a force majeure event meet the relevant criteria under law or contract, as described above;
- the existence of a causal link between these circumstances and the inability to perform the relevant obligations under the contract (including the defaulting party having also taken all necessary measures to properly perform its obligations under the contract and there being an absence of any evidence which would indicate the defaulting party's bad faith in taking such measures).

For foreign trade transactions, the applicability of force majeure is initially determined by the Russian CCI after considering an application to that effect by the defaulting party. The Russian CCI will analyse the relevant documents submitted with the defaulting party's application to confirm the applicability of the relevant force majeure circumstance (i.e. an event associated, for example, with a prevalent disease or the adoption of special restrictive measures aimed at preventing its spread).

After making such a determination, the Russian CCI will issue a certificate in relation to the circumstances of force majeure. This procedure is regulated extensively by a special regulation¹. Such a certificate may be used as evidence that the circumstances in respect of which it was issued have met the criteria for qualification as a force majeure event under Russian law; however, possession of the Russian CCI's certificate will not release the defaulting party from the need to prove the causal link between such circumstances and the defaulting party's failure to perform its obligations under the relevant contract.

For other contracts governed by Russian law, which are not foreign trade transactions, the general rules of Article 401(3) of the Russian Civil Code apply. In the event of a dispute over force majeure in court, the burden of proving its occurrence falls on the party invoking force majeure as a defence for the failure to perform its obligations under the relevant contract. In such case, the party invoking force majeure is not limited in terms of the selection of evidence it may adduce to establish that a force majeure event has occurred, and may include reference to the Decree of the Mayor of Moscow dated 05.03.2020 No. 12-UM "On Introduction of the High Alert Regime" (as amended).

In a number of cases, the Russian courts have considered certain circumstances to be "well-known facts" that do not require additional explanation or verification from the authorised bodies².

Judicial determination of force majeure

The conclusive determination of the relevant circumstance as a force majeure event is carried out by the court. Evidence from the Russian CCI or other evidence of the occurrence of force majeure so provided by the parties will not carry any predetermined weight with the court. Such evidence is subject to evaluation by the court on a case-by-case basis, along with other evidence which takes into account the wider circumstances of the specific case.

The defaulting party retains the obligation to prove the legal grounds for its release from liability under the relevant contract, as well as the obligation to provide evidence that it complied with the procedure for notifying the contract counterparty of the occurrence of force majeure, in accordance with any relevant provisions of the contract, and took reasonable measures to mitigate its effects¹². In addition to the relevant contractual provisions, the defaulting party is obliged to be guided by the general provisions of Russian law on the performance of obligations in good faith, the mutual assistance of the parties to achieve the objective of the obligation and the provision of all relevant information to each other party. Otherwise, the defaulting party could bear the risk of making compensation to the non-defaulting party in respect of any losses incurred in connection with:

- the non-performance of the defaulting party's obligations under the contract;
- the defaulting party's obligations to provide the non-defaulting party with all the necessary information in respect of the circumstances which it claims constitute a force majeure event; and
- any other impact on the obligations of the contracting parties under the relevant contract, including in respect of any measures taken by the defaulting party to minimise the impact of the force majeure event.

IMPACT OF COVID-19 ON THE VALIDITY OF PRIOR CONTRACTS

A defaulting party who has breached an obligation due to a force majeure event (as properly determined by the Russian court) is not liable to the non-defaulting party for non-performance of its obligations (improper performance) under the relevant contract. Although, the recognition of the COVID-19 pandemic as a force majeure event by the court may release the defaulting party from liability to the non-defaulting party for breach of contract, it will not release it from performance of the obligation itself. Whether the obligation is continuing will depend on whether it remains possible to perform the relevant obligation once the force majeure circumstances are no longer sustained.

Termination of the contract at the initiative of the creditor (Article 405(2) of the Russian Civil Code)

If the performance of the contract after the cessation of the force majeure circumstances is possible, the force majeure event will not discharge the defaulting party from performing its relevant obligation under the contract. At the same time, the non-defaulting party has the right to repudiate the contract if, as a result of the delay, it is no longer interested in receiving the benefit under the contract, provided that the defaulting party shall not be liable to the non-defaulting party for any losses caused by the delay in performing the obligations due to the occurrence of the force majeure circumstances¹³.

Termination of the contract due to actual impossibility of execution (Article 416 of the Russian Civil Code)

Termination of the relevant contractual obligations on the basis of Article 416 of the Russian Civil Code may take place if, in connection with certain circumstances arising after execution of the contract, there is an actual, objective and permanent impossibility of performance¹⁴ of those obligations.

Based on the information presently available, it is difficult to attribute such conditions to the COVID-19 pandemic and the various measures taken to contain its transmission. Despite the uncertainty regarding the duration of such containment and preventative measures, it is clear that they are temporary.

On the basis of this analysis, the relevant contractual obligations of the defaulting party cannot be terminated.

However, force majeure provisions in commercial contracts often contain mechanics allowing for unilateral rescission of the contract, including in the case of temporary impossibility of performance (in particular, in connection with measures taken against the spread of COVID 19) after a certain period of time has elapsed following the occurrence of the force majeure event in question and following notification by the defaulting party to the non-defaulting party.

Termination of the contract due to legal impossibility of performance (Article 417 of the Russian Civil Code)

Termination of obligations by virtue of Article 417 of the Russian Civil Code is possible if state or local authorities adopt acts or measures that make it impossible (i.e. illegal) to perform obligations under an agreement concluded by the parties. That is to say, in the case of legal impossibility of contractual performance.

Consideration of Article 417 of the Russian Civil Code is relevant when analysing the legal acts which are currently being adopted by state and local authorities to establish various actions and restrictive measures to be taken in connection with the effects of COVID-19.

These can be *de facto* grounds for termination of contractual obligations for the purposes of Article 417 of the Russian Civil Code.

However, it should be noted that upon repeal of the relevant legal acts, the terminated obligation may be restored if the party that had previously been entitled to receive something under the contract does not repudiate the contract within a reasonable time.

Rescission / modification of contract (Article 451 of the Russian Civil Code)

Can the current situation with COVID-19 be considered a material change of circumstances?

Unlike the situations above, in case of a material change of circumstances, contract counterparties might still have an opportunity to perform their obligations. However, the parties may not be prepared to perform their obligations due to a number of unforeseen events which occurred after execution of the contract.

According to Article 451(1) of the Russian Civil Code, a material change in the circumstances upon which the parties relied when executing the contract is a ground for modifying or rescinding the relevant contract. A change of circumstances is regarded as material when the parties' circumstances have changed in such a way that the parties would not have entered into the contract at all, or would have entered into it on significantly different terms, had they been able to reasonably foresee the change.

The practical application of this provision is highly limited due to it being construed narrowly by the Russian courts such that it is applied only in the most exceptional cases. The Russian court imposes a fairly high test in relation to materiality, which the relevant change in circumstances must meet. Courts usually refuse to classify events that fall into the category of entrepreneurial risk as a material change of the parties' circumstances. However, it is also possible that measures taken in connection with the spread of COVID-19 could make the fulfilment of contractual obligations so burdensome for the parties that they will be categorised by the courts as a material change of circumstances. This means that the parties will be able to rely on a material change in circumstances for the purpose of rescinding or modifying the relevant contract in accordance with Article 451 of the Russian Civil Code.

In addition, it should be noted that if the parties fail to reach a consensus as to whether there has been a material change in their circumstances, the court may intervene in the process of rescission or modification of the contract, provided that the conditions stipulated in Article 451(2) of the Russian Civil Code are met. The court may also determine the specific consequences of rescission or modification of the contract on the counterparties' behalf.

PRACTICAL RECOMMENDATIONS

The legal concepts described above are intended, first of all, to protect parties against the risk of non-performance of contractual obligations by their counterparties where such parties encounter practical difficulties around performance due to the effects of COVID-19. Of course, some market participants may try to manipulate these legal concepts to their advantage in order to terminate, rescind or suspend transactions that have become merely less profitable for them or to apply pressure on their counterparties to amend the terms of the relevant contract to their benefit.

From the point of view of practical recommendations for defaulting parties who have faced (or may face) adverse consequences in relation to COVID-19, we recommend that they take some of the following actions:

1. review the terms of their commercial contracts to identify the relevant provisions, if any, which govern the occurrence of force majeure events or circumstances;
2. seek advice as to whether the relevant circumstances will constitute a force majeure event under Russian law or under the provisions of the relevant contract, or a material change of circumstances for the purposes of Article 451 of the Russian Civil Code;
3. establish communication with the relevant counterparty in good time in order to comply with any obligations to notify that counterparty and to provide it with the required information regarding the circumstances which may affect performance of the parties' contractual obligations (or to notify the counterparty of a change in circumstances even if there is no corresponding notification obligation under the contract);
4. evaluate the list of measures and other contingency plans that can be taken to minimise the negative impact of the current situation on the obligations of the defaulting party under the contract – in particular, consider alternative ways of performing contractual obligations such as by obtaining the contractual subject matter from other sources (taking into account that entrepreneurial risks rarely act as grounds for releasing the parties from liability); and
5. evaluate the possibility and expediency of terminating the relevant contract in the context of the evolving circumstances relating to COVID-19 and consider making any necessary amendments to the contract (subject to the general requirement for performance of obligations in good faith).

From the perspective of non-defaulting parties, in respect of the affected contractual obligations, it is crucial to establish early communication with the contract counterparty in order to avoid being deemed to have waived any accrued contractual rights. A number of rights may also arise in favour of the non-defaulting party relating to the unilateral repudiation or modification of the contract, in connection with a breach of obligations by its contract counterparty. Non-defaulting parties should be advised that the exercise of such rights under Russian law must be based on the principle of good faith– otherwise, judicial protection of such rights may be denied, and the non-defaulting may be required to compensate the defaulting party for losses caused by its bad faith behaviour.¹⁵

[1] The Decree of the Mayor of Moscow No. 12-UM dated 5 March 2020 "On Introduction of the High Alert Regime" (as amended by the Decrees No. 17-UM dated 14 March 2020, No. 21-UM dated 16 March 2020, No. 25-UM dated 19 March 2020, No. 26-UM dated 23 March 2020.

[2] The high alert regime has been introduced throughout the whole of Russia due to COVID-19 /

<http://rg.ru/2020/03/19/na-vsej-territorii-rf-vveden-rezhim-povyshennoj-gotovnosti-iz-za-covid-19.html>.

[3] <http://www.euro.who.int/ru/health-topics/health-emergencies/coronavirus-covid-19/news/news/2020/3/who-announces-covid-19-outbreak-a-pandemic>.

[4] http://cbr.ru/press/PR/?file=17032020_090000dkp2020-03-17T08_57_06.htm.

[5] <http://government.ru/orders/selection/401/39204/>.

[6] The Federal Law No. 44-FZ dated 5 April 2013 "On Contract System in State and Municipal Procurement of Goods, Works and Services".

[7] Clause 8 of the Resolution of the Plenum of the Supreme Court of the Russian Federation No. 7 dated 24 March 2016 "On Application by Courts of Certain Provisions of the Russian Civil Code on Liability for Breach of Obligations".

[8] This criterion is debatable and is not recognised by all researchers (Contract and Liability Law (General Part): Article-by-Article Commentary to Articles 307 - 453 of the Russian Civil Code // edited by A.G. Karapetov, "M-Logos", 2017).

[9] See the Resolution of the Presidium of the Supreme Arbitrazh Court of the Russian Federation No. 3352/12 dated 21 June 2012, Clause 8(4) of the Resolution of the Plenum of the Supreme Court of the Russian Federation No. 7 dated 24 March 2016 "On Application by Courts of Certain Provisions of the Russian Civil Code on Liability for Breach of Obligations".

[10] Annex to the Resolution of the Board of the Russian CCI No. 173-14 dated 23 December 2015.

[11] See the Resolution of the Arbitrazh Court of the Moscow District dated 24 October 2018 No. F05-17333/2018 in case No. A41-73316/2017: "Introduction of EU sanctions is a well-known fact and does not require notification or additional evidence about it".

[12] Clause 10 of the Resolution of the Plenum of the Supreme Court of the Russian Federation No. 7 dated 24.03.2016 "On Application by Courts of Certain Provisions of the Russian Civil Code on Liability for Breach of Obligations".

[13] Clause 9 of the Resolution of the Plenum of the Supreme Court of the Russian Federation No. 7 dated 24.03.2016 "On Application by Courts of Certain Provisions of the Russian Civil Code on Liability for Violation of Obligations".

[14] Contract and Liability Law (General Part): Article-by-Article Commentary to Articles 307 - 453 of the Russian Civil Code // edited by A.G. Karapetov, "M-Logos", 2017.

[15] Clause 15 of the Resolution of the Plenum of the Supreme Court of the Russian Federation No. 64 dated 22 November 2016 "On Certain Issues of Application of the General Provisions of the Russian Civil Code on Obligations and Performance Thereof".

[More on Navigating the COVID-19 Outbreak](#)

KEY CONTACTS

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