ALRUD

Newsletter

A guide to contract work during the crisis

May 13th, 2020

Dear Ladies and Gentlemen,

In times of the ongoing crisis, associated with the spread of the novel coronavirus infection (COVID-19), and the introduction of epidemiological requirements and restrictions, many businesses have faced difficulties with contractual performance, including the failure in supply, cancellation of scheduled events and often cutbacks in profits and the impossibility to perform monetary obligations.

In such a situation, companies are forced to decide the future of concluded contracts, at short notice, and may seek legal means to properly perform their obligations, or to distribute the risks relating to suspension, or termination, of obligations that have become difficult, or impossible, to perform.

This guide does not purport to cover all possible situations regarding the failure to perform commercial contracts during the crisis. However, we have done our best to collect answers to the most common legal issues about contract work, during financial and other shocks faced by Russian companies and their foreign partners.

1 What to do with a contract, performance of which has become impossible, or unprofitable, in times of the crisis?

Depending on the specific circumstances, the contract can be terminated due to the impossibility of performance (Articles 416 and 417 of the Civil Code of the Russian Federation), amended, or terminated, due to a material change of circumstances (Article 451 of the Civil Code of the Russian Federation). You can suspend performance and exclude liability for a delay due to 'force majeure' (Clause 3 of Article 401 of the Civil Code of the Russian Federation), or restructure the obligations of the parties, by modifying the terms of the contract (on price, terms, performance, etc.), or by terminating it (unilateral refusal, set-off, novation, compensation for release from obligations etc.). The set of tools, and the choice of a specific instrument, depends both on the conditions of the concluded contract and on the actual circumstances of its performance. At the same time, it is necessary to take into account the specifics of the applicable legislation and enforcement practices, as well as to ensure proper formalization, in order to exclude the risk of subsequent judicial challenge.

2 In what cases, and how, can a contract be terminated due to the impossibility of its performance?

The occurrence of force majeure circumstances does not in itself terminate the obligation if performance remains possible after such circumstances have ceased to exist. However, in cases where performance of an obligation is hindered by physical impossibility (that is, the obligation from the contract cannot be objectively performed by any person[1]), or legal impossibility (when the obligation can be physically performed, but this will be a violation of an act of a state authority, or local government), such obligation

[1] Para. 21 of the Review of case law, approved by the Presidium of the Supreme Court of the Russian Federation of April 26th, 2017.

shall terminate automatically. Physical impossibility includes, in particular, the loss of an individually-defined object intended for transfer, or use, under the contract. Legal impossibility includes the introduction of export, or import, restrictions. It is important that the circumstance that led to the impossibility of performance of the contract arises after its conclusion, and does not depend on any of the parties.

The Supreme Court of the Russian Federation in the "Review on certain issues of judicial practice related to the application of legislation and measures to counteract the spread of novel coronavirus infection (COVID-19) No. 1 in the Russian Federation", approved by the Presidium of the Supreme Court of the Russian Federation of April 21th, 2020 ("**Review No. 1**"), confirmed that the spread of novel coronavirus infection, and the restrictive measures taken in connection with this, could lead to the termination of contractual obligations due to the complete, or partial, impossibility to perform them, on the basis of Articles 416 and 417 of the Civil Code of the Russian Federation.

To terminate the contract due to the impossibility of its performance, prepare a written notice on the termination of the contract, indicating the circumstances that impede performance of contractual obligations, and send such notice to your counterparty at the address of registration (indicated in the Unified State Register of Legal Entities, or Unified State Register of Individual Entrepreneurs), or at the address indicated in the contract.

3 In what cases, except as indicated in paragraph 2, is a party entitled to initiate the termination, or amendment, of the contract unilaterally, for reasons related to COVID-19?

If the right to a unilateral termination of a contract, or a change in its terms, is provided by law, or the contract (Article 450.1 of the Civil Code of the Russian Federation), it is not required to apply to the court. It is enough to notify the counterparty about the termination, or amendment, of the contract by sending him/her a written notice, in accordance with the procedure laid down in the contract, or the provisions of the law on sending legally relevant messages (Article 165.1 of the Civil Code of the Russian Federation). The contract will be deemed terminated, or amended, from the date the counterparty received such notice, unless otherwise provided in the notice, contract, or law.

If the right to unilateral termination of the contract, or change of its conditions, is not provided (in general, or for the current situation), then you can use the following tools:

(A) the creditor has the right to refuse to perform the contract, if he/she has lost interest in connection with the delay of the debtor[2], including for reasons related to COVID-19. The debtor does not have such a right, unless it is expressly provided for by the contract;

(B) the creditor has the right to terminate the contract in the event of a foreseeable breach of the contract by the debtor, that is, if there are circumstances that clearly indicate that such performance will not be made on time[3] (for example, if the contractual delivery time for the goods in respect of which export, or import, restrictions have been introduced, although will be effective in the future, it will obviously fall within the period of validity of such restrictive measures, which will lead to a violation of the contract);

(C) in addition, the contract may be terminated, or amended, due to a material change of circumstances[4] if the interested party proves[5] that the following conditions apply simultaneously: (i) at the conclusion of the contract, the parties believed that such changes would not occur; (ii) the reasons for the changes are insurmountable; (iii) the

[2] Para. 2 of Art. 405 of the Civil Code of the Russian Federation (hereinafter –"**CC RF**"), para. 9 of the Resolution of the Plenum of the Supreme Court of the Russian Federation of March 23rd, 2016 No. 7 "On application by the courts of certain provisions of the Civil Code of the Russian Federation on liability for breach of obligations" (hereinafter – "**Resolution of the Plenum of the Supreme Court of the Russian Federation No. 7**").
[3] Para. 2 of Art. 328 of the CC RF.
[4] Art. 451 of the CC RF.
[5] The decision of the Presidium of the Supreme Arbitrage Court of the Russian Federation of October 14th, 2008 No. 5934/08; the decision of the Supreme Court of the Russian Federation of August 8th, 2016 No. 57-KG16-7.

interested party does not bear the risk of changing circumstances and (iv) negative consequences will come for him/her in terms of such damage that the interested party did not expect when concluding the contract, if the contract is performed unchanged. In its Review No. 1, the Supreme Court of the Russian Federation confirmed that the circumstances of the spread of COVID-19 may be the basis for the requirement to amend, or terminate, the contract due to a significant change in circumstances[6]. However, it is important to consider that the contract may exclude the right of the parties to invoke the material change of circumstances, as a basis for amending, or terminating the contract.

In all these cases, the party initiating the amendment, or termination, of the contract should send the counterparty a written notice, or proposal, to amend, or terminate, the contract. In case of rejection of the proposal to amend, or terminate, the contract (including due to a material change of circumstances), or in case of failure to receive a response to the proposal, to terminate, or amend, within 30 days[7] from the date of its sending, the interested party has the right to apply to the court, with a corresponding lawsuit[8].

4 Is it possible to avoid liability for non-performance, or breach of contract, in the crisis (including due to COVID-19)?

As a general rule, a party that has carried out entrepreneurial activities is responsible for non-performance, or breach, of obligations, even in the absence of fault. The only exception is non-performance, or breach, of the contract caused by the occurrence of extraordinary and unforeseeable circumstances, for which neither of the parties is responsible (force majeure)[9]. To date, in judicial practice, an approach has been formed, according to which breach of obligations on the part of the debtor's counterparties, lack of necessary goods on the market, lack of cash, the financial crisis[10], illegal actions of third parties[11], devaluation of the national currency and rate fluctuations[12], bankruptcy of a debtor's counterparty[13] or revocation of a license[14] are not considered to qualify as force majeure circumstances. Thus, if non-performance, or breach of the contract, is due to one of the indicated circumstances, you may need to turn to other tools, for example, refer to the objective impossibility of performance of the contract (*paragraph 2*), a material change of circumstances (*paragraph 3*), or initiate negotiations on changing the terms of the contract, for period of the crisis (including for the period of the circumstances related to COVID-19).

The recognition of the circumstances related to COVID-19 as force majeure depends on the terms of the contract itself, as well as on the specific circumstances of its performance. Thus, the Supreme Court of the Russian Federation clarified that recognition of the spread of novel coronavirus infection as force majeure cannot be universal for all categories of debtors, regardless of the type of their activity, the conditions for its implementation, including the region in which the organization operates. The existence of the force majeure circumstances must be established, taking into account the circumstances of a particular case (including the deadline for performance of the obligation, the nature of the unperformed obligation, the reasonableness and good faith of the actions of the debtor, etc.)[15]. It is important to note the position of the Supreme Court of the Russian Federation, as provided for in Review No. 1, according to which, in some cases related to COVID-19, the lack of necessary funds can also be recognized as

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[6] Question 8 of the Review No. 1.
7 Para. 2 of Art. 452 of the CC RF.
[8] Please note that due to a fundamental change in the circumstances (see section (C)), the contract, as a general rule, is terminated by a court decision. The contract in the event of a fundamental change in the circumstances may be amended by the court decision in *exceptional cases* specified in paragraph 4 of Article 451 of the CC RF.
[9] Para. 3 of Art. 401 of the CC RF.
[10] Para. 3 of Art. 401 of the CC RF.
[11] The decision of the Presidium of the Supreme Arbitrage Court of the Russian Federation of June 9, 1998 No. 6168/97.
[12] The decision of the Arbitrage Court of the Moscow District of August 3rd, 2017 No. Ф05-9562/2017 in the case No. A40-129109/2016.
[13] The decision of the Supreme Court of the Russian Federation of December 6th, 2005 No. 49-B05-19.
[14] The decision of the Arbitrage Court of the Moscow District of March 28th, 2016 No. Ф05-2728/2016.
[15] Question 7 of the Review No. 1.

force majeure (despite the fact that such a circumstance is not traditionally recognized as force majeure, in judicial practice).

See *paragraph 5* and *paragraph 6* for how to properly notify the counterparty of the force majeure circumstances and what evidence should be provided.

Negotiations to amend, or terminate, the contract should be recorded, and all changes to the terms of cooperation should be recorded in the form of supplementary agreements, or annexes to the current contract. If it is impossible to determine the procedure for further performance of the contract by the current date, indicate in the supplementary agreement that the parties are not responsible for non-performance of obligations, during the crisis (in particular during COVID-19), as well as the obligation of the parties to negotiate, after a specified period of time, to determine the future of the contract and agree liability for non-performance of such obligation.

5 How to properly notify the counterparty of the force majeure circumstances?

The term and force majeure notification procedure may be specified in the contract. If the procedure is agreed, it must be followed, otherwise a force majeure clause might not be effective.[16] If the notification procedure has not been agreed, the written notice of the occurrence of force majeure should be given to the counterparty as soon as possible, to avoid claims for damages[17]. If the contract does not specify the parties' addresses to send legally-relevant notifications, the notification should be sent to the registration address of the counterparty, specified in the Unified State Register of Legal Entities, or Unified State Register of Individual Entrepreneurs[18]. Notice will be deemed received from the date of delivery, unless the parties have provided for other rules in the contract[19]. Proof of force majeure should be attached to the notice (see *paragraph 6*).

6 How to prove the causal link between a force majeure event and non-performance?

The parties may agree, in the contract, a list of force majeure evidence that will be conclusive, for instance, indicate a force majeure certificate issued by the Chamber of Commerce and Industry of the Russian Federation ("**RF CCI**"). Kindly note that RF CCI may issue certificates only for force majeure events that have occurred on the territory of Russia and arisen as part of performance of a foreign trade contract. In order to confirm force majeure events that have occurred in the territory of other states, it is necessary to apply to a competent authority of those states. You should not rely on a certificate of RF CCI, if a contract is not a foreign trade contract. In this case, as evidence, indicate that a certificate of occurrence of a force majeure event issued by chambers of commerce and industry of constituent territories of the Russian Federation[20]. To avoid disputes arising from new contracts, specify that the document confirming the occurrence of force majeure circumstances should be issued by the RF CCI (in case of local contracts – CCI of a constituent territory of the Russian Federation), or another competent authority.

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[16] See, for example, the Resolution of the Arbitrage Court of the North-Western District of February 7th, 2017 N F07-11803/2016 in the case No. A05-551/2016 (Ruling of the Supreme Court of the Russian Federation of April 18th, 2017 No. 307-EWS17-4115 denied the transfer of the case No. A05-551/2016 to the Judicial Collegium for Economic Disputes of the Supreme Court of the Russian Federation for review in cassation proceedings of this decision), Resolution of the Arbitrage Court of the Moscow District dated September 2nd, 2019 in case No. A41-90677/2018, Resolution of the Arbitrage Court of the Volga District dated June 8th, 2018 No. F06-33131/2018 in case No. A65-20171/2017.
[17] Para. 10 of the Resolution of the Plenum of the Supreme Court of the Russian Federation No. 7.
[18] Para. 3 of Art. 54 of the CC RF, para. 63 of the Resolution of the Plenum of the Supreme Court of the Russian Federation of June 23rd, 2015 No. 25.
[19] Para. 1 of Art. 165.1 of the CC RF.
[20] Protocol of the Government Commission on Increasing Sustainability of the Russian Economy Development No. 3 of March 20th, 2020.

7 How to calculate the terms of contractual performance in the context of "non-business days" introduced in Russia?

The term of performance of the contractual obligation is calculated in calendar days, if calculation in business days is not directly specified by law, or the contract. If the last day of the term is a non-business day, the day of expiry of the term will be the next business day[21]. Since the Decrees of the President of the Russian Federation[22] declared the days from March 30th to May 11th, 2020 to be "non-business", the question arises of performance of the obligation, the deadline for which falls on the period of such "non-business days."

According to the Review No. 1 and the "Review on certain issues of judicial practice related to the application of legislation and measures to counteract the spread of novel coronavirus infection (COVID-19) No. 2 in the Russian Federation", approved by the Presidium of the Supreme Court of the Russian Federation on April 30th, 2020 ("**Review No. 2**"),"non-business days" are among the measures established to ensure the sanitary and epidemiological well-being of the population, aimed at preventing the spread of novel coronavirus infection (COVID-19), and cannot be regarded as "non-business days" in the meaning assigned to it by Civil Code of the Russian Federation[23]. In the sense of the Reviews, otherwise it would mean a suspension of performance of all civil obligations, without exception for a long period, and a significant restriction of civil circulation in general. Such interpretations do not meet the goals of the said Decrees of the President of the Russian Federation. In this regard, if there are no grounds for exemption from liability for non-performance of the obligation (Article 401 of the Civil Code of the Russian Federation), the establishment of non-business days in the period from March 30th to May 11th, 2020 is not a basis for postponing the time for performance of obligation, on the basis of the provisions of Article 193 of the Civil Code of the Russian Federation.

The same rule applies to government and municipal contracts, for which from April 4th to May 11th, 2020, inclusive, terms specified by law[24] and regulations and calculated in business days, are calculated in calendar days (without regard to Saturdays and Sundays). If the last day of the term is a "non-business day", the day of expiry shall be that non-business day, and if it is a Saturday or Sunday, the next Monday.[25]

8 What should be included in a force majeure clause, for contracts concluded during COVID-19, and after that?

The contract should establish what circumstances are qualified as force majeure, the procedure, form and term for notification of the occurrence of a force majeure event, as well as agree on a list of evidence of force majeure. If the parties are interested in maintaining the obligation for the period of the crisis, we recommend to include a clause that the occurrence of force majeure does not terminate the contract (either completely, or partially). It is reasonable to agree that, upon expiry of the period of validity of the force majeure circumstances agreed upon by the parties (for example, 2 – 3 months), each party, or one of the parties, has the right to refuse further performance of the contract in an out-of-court procedure.

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[21] Art. 190 of the CC RF, Art. 193 of the CC RF.

[22] The Decree of the President RF of April 2nd, 2020 No. 239 "On measures to ensure sanitary-epidemiological well-being of the population in the territory of the Russian Federation in connection with novel coronavirus infection spread (COVID-19)".

[23] The weekend and non-business days mentioned in the CC RF should be determined in accordance with Art. 111 and 112 of the Labor Code of the Russian Federation.

[24] Federal Law No. 44-FZ of April 5th, 2013 "On the Contract System for the Procurement of Goods, Works and Services to Support State and Municipal Needs".

[25] The Resolution of the Government of the Russian Federation of April 3rd, 2020 No. 443 "On the peculiarities of procurement during the period of taking measures to ensure sanitary-epidemiological well-being of the population in the territory of the Russian Federation in connection with the novel coronavirus infection spread".

9 Should COVID-19 be expressly mentioned as a force majeure event in contracts entered into, prior to the lifting of restrictive measures?

Force majeure events may include only those events that are both extraordinary and inevitable. That is, those are exceptional circumstances that are not customary, under given conditions, and any party, engaged in a similar activity as a debtor in question, could not have prevented their occurrence (nor their consequences)[26]. Kindly note that, if certain events are named as force majeure in an agreement, it does not automatically mean that they will be qualified as such by the court, in case of disputes. Further, in case a contract is made during the COVID-19 period, the court may hold that the coronavirus is not a force majeure event, since it does not satisfy the criteria of an "extraordinary" event, which is similar to disputes arising from contracts concluded during the period of international sanctions.[27] In this regard, in our opinion, it is more effective to distribute the risks of introducing new restrictive measures, due to COVID-19, through contractual institutions of compensation of property losses, waiver of rights and a contract withdrawal (see *paragraph 10*).

10 What clauses to include in the contract made during COVID-19?

The Civil Code of the Russian Federation allows the parties to agree, in advance, on indemnity clauses (compensation of property losses), related to occurrence of circumstances specified in the contract, that are not related to the parties' breach of their obligations[28], including in case novel COVID-19-related restrictive measures are introduced. In order for the indemnity clause to be valid and enforceable, it is necessary to specify the amount of the indemnified losses (fixed amount, or calculation formula) and the range of circumstances, which upon their occurrence, allow the party to claim such indemnity. Apart from indemnity clauses, we recommend including a clause on the right of the parties (or one of them) to unilaterally refuse to continue with the contract (in whole, or in part, affected by the restrictive measures) in the event of the certain circumstances (for example, in the case of the introduction of new restrictive measures, or in the absence of the necessary goods on the market, or in case the other party becomes insolvent).

Among other things, in long-term contracts, you should be more careful about the conditions for the calculations of prices, in particular, include the conditions for the revision of the price upon the occurrence of the agreed circumstances. At the same time, the terms of the contract that "the price may be changed" will most likely not be enough. It is worth carefully considering monetary clauses, which should meet the interests of the parties, in the event of a devaluation of the national currency, or other financial shocks. For example, in the contract you can specify a fixed exchange rate, or to include a formula for calculating the price, when experiencing fluctuation of the exchange rates.

In times of the crisis associated with the spread of COVID-19, the conclusion, amendment, or termination of the contract using electronic, or other technical, means became even more relevant (Articles 160 and 434 of the Civil Code of the Russian Federation). In order to give legal force to the contract concluded, in particular, by exchanging emails, or using platforms for generating and verifying electronic signatures (DocuSign, etc.), the parties shall conclude an agreement on electronic interaction.

For up-to-date legislative news and business-related guidance in connection with COVID-19, please visit our dedicated webpage:

COVID-19: What you need to know

[26] Para. 3 of Art. 401 of the CC RF, para. 8 of the Resolution of the Plenum of the Supreme Court No. 7, the Resolution of the Presidium of Supreme Arbitrage Court of the RF of June 21st, 2012 No. 3352/12.
[27] Para. 8 of Resolution of the Plenum of the Supreme Court of the Russian Federation No. 7.
[28] Art. 406.1 of the CC RF.

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