

# Russian Supreme Court Rules on “Take-Or-Pay” Provision in Russian Law Contracts

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The Supreme Court of the Russian Federation (the “SC”) examined in detail the “*take-or-pay*” arrangement in Russian law governed contracts which is significant primarily for the commodities delivery and off-take market and clarified the consequences of unilateral repudiation of such contract by the customer/purchaser.<sup>1</sup>

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## Take-or-Pay Provision

This arrangement, along with the mirror “*deliver-or-pay*” provision, is frequently used in practice, for example, in contracts of metals, energy, oil and gas companies, and various commodities producers, including off-take contracts (contracts for the supply of future products). However, such provision may appear both in the supply or off-take agreements and in, *e.g.*, services agreements as in the subject Ruling.

The Russian-law-governed contracts generally provide for a payment obligation in the event of failure to take or deliver by requiring payment of a (i) penalty, or making a (ii) price adjustment. However, if the payment obligation is based on the concept of penalty it gives rise to the risk of reduction of such payment by the court pursuant to Article 333 of the Russian Civil Code.<sup>2</sup>

Consideration can also be given to structuring the “*take-or-pay*” provision with the application of (i) primary and secondary obligations (Articles 308.1–308.2 of the Russian Civil Code); (ii) a subscription agreement (where the customer/purchaser makes fixed payments and receives performance on request from the provider/seller) (Articles 429.4 of the Russian Civil Code); or (iii) repudiation of contract with the obligation to pay a certain fee for such repudiation.

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<sup>1</sup> [Ruling of the Judicial Panel on Economic Disputes of the Russian Supreme Court No. 305-ES21-10216 dated 20 August 2021 in Case No. A40-328885/2019](#) (the “Ruling”).

<sup>2</sup> See, *e.g.*, Judgement of the *Arbitrazh* Court of Novosibirsk Region in Case No. A45-4715/2017 dated 5 July 2017; Judgement of the *Arbitrazh* Court of Novosibirsk Region in Case No. A45-3134/2017 dated 7 August 2017; Ruling of the Sixth *Arbitrazh* Appeals Court No. 06AP-819/2020 dated 23 July 2020 in Case No. A73-22344/2019.

The Russian law indemnification (the *indemnity* instrument similar to it is used, among others, to structure the “*take-or-pay*” provision in English law contracts) is not applicable in this situation as Russian law expressly prevents the establishment of the obligation to reimburse losses related to the breach of obligation by the indemnifying party (*i.e.* failure to take or deliver) (Article 406.1(1) of the Russian Civil Code).

However, given that there is no settled court practice, the Russian law contracts incorporating the “*take-or-pay*” model<sup>3</sup> continue to raise questions regarding how to structure such provision, and the SC has made a significant step by providing a detailed analysis of such provision and indicating that the “*take-or-pay*” condition can be included as payment for repudiation of contract.<sup>4</sup>

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## Facts of the Case

LLC OTEKO-Portservice (the “operator”) and Swiss-based Kaproben (*KAPROBEN HANDELS AG*) (the “customer”) entered into a contract where the operator agreed to perform certain works and render services to the customer relating to freight forwarding, transshipment, storage and stockpiling of hardcoals for further transportation across the border of the Russian Federation, and perform other works and render services in the course of transshipment for the fee agreed in the contract.

In its turn, the customer agreed to deliver the coal in a timely manner for transshipment in the agreed volumes and pay a penalty to the operator for any short delivery of coal at the transshipment rate set forth in the contract (the “*take-or-pay*” principle). The customer unilaterally repudiated the contract for no reason and notified the operator accordingly. The operator considered that such repudiation was inappropriate and filed a claim with the court.

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<sup>3</sup> Due to the uncertain nature of the “*take-or-pay*” or “*deliver-or-pay*” arrangements under Russian law, these transactions are sometimes structured under English law where various approaches are available for the application of the “*take-or-pay*” or “*deliver-or-pay*” provisions which can include, *e.g.*: (i) liquidated damages; (ii) indemnity; (iii) primary and secondary obligations; and (iv) price adjustment.

<sup>4</sup> When structuring the “*take-or-pay*” provision, it is important to take account of all terms and conditions and background facts of the transaction and relations of the parties, including matters relating to the implementation of a specific project, determination of the volume and price for products or services, tax, customs, and other issues. All these and other factors can give rise to differing legal treatments of this provision in each transaction.

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## Supreme Court Position

- The customer is entitled to unilaterally terminate the services agreement, this right is contemplated by law (Article 782(1) of the Russian Civil Code) and such right to terminate is an imperative rule that cannot be restricted/excluded by contract.

However, such right of the customer to terminate the contract can be made conditional upon the payment by the customer of a repudiation fee agreed by the parties and such fee is not inconsistent with the unconditional right of the customer to repudiate the contract.<sup>5</sup>

- Despite the “*take-or-pay*” arrangement not being expressly addressed in Russian law, the freedom of contract principle enables the parties to create various contractual arrangements going beyond the contractual models envisaged by the Russian Civil Code.<sup>6</sup>
- The customer’s/purchaser’s right to unilateral repudiation is not by itself inconsistent with the “*take-or-pay*” arrangement as the customer is free not only to refrain from using the provider’s/supplier’s services, but also to discontinue using them at all, however, it cannot release the customer/purchaser from its obligation to pay.
- In this case, the customer’s payment for the failure to deliver coal for transshipment on the “*take-or-pay*” terms can be treated as payment for the repudiation of contract (Article 310(3) of the Russian Civil Code) determined on the basis of the effective period of the “*take-or-pay*” provision agreed by the parties.
- Legally speaking, the “*take-or-pay*” provision consists of two separate obligations:
  - (i) the **obligation to “take”** means the customer’s/purchaser’s subjective right to receive a certain volume of performance (goods or services) by the other party (provider/supplier) over a certain period of time and such subjective right may be exercised or waived at the sole discretion of the customer/purchaser; and

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<sup>5</sup> This conclusion was previously articulated in para. 4 of Ruling No. 16 of the Plenary Session of the Higher Arbitrazh Court of the Russian Federation dated 14 March 2014 on Freedom of Contract and the Scope of Such Freedom of Contract where it was indicated that unilateral repudiation by a party of a services agreement related to the conduct of business by both parties thereto can be made conditional upon making a certain monetary payment to the other party.

<sup>6</sup> In addition, legal rules similar to the above model are already contained in various Russian regulations (e.g., *Clauses 5 and 16 of the Rules of Gas Delivery in the Russian Federation approved by Decree No. 162 of the Russian Government dated 5 February 1998*).

- (ii) the **obligation to “pay”** means the subjective right of the other party (provider/supplier) to require payment from the counterparty even if the customer/purchaser did not exercise its right to receive the agreed volume of performance (goods or services) from the provider/supplier.
- The compensatory nature of such provision is ensured by making significant additional benefits that have their own value available to the customer, for example: (i) reserving production capacity for its needs; (ii) guaranteeing provision of services on a priority basis at any time; (iii) removing a certain volume of the provider’s services/goods/works from the markets specifically for the customer; (iv) reducing prices compared to those for other customers; (v) fixing the price for a long period; and (vi) customising the provider’s production facilities for the customer’s needs, including by making capital expenditures for their upgrade, etc.

When structuring the “*take-or-pay*” provision as payment for repudiation of contract it is important to keep in mind that such payment **can be reduced by the court if its amount is clearly disproportionate to the adverse consequences** and if the right to require payment in the respective amount<sup>7</sup> is exercised in bad faith similar to the reduction of the penalty when the “*take-or-pay*” provision is based on the penalty mechanism. In addition, payment for contract repudiation can also be reduced where the parties that conduct business have equal bargaining power in negotiating such arrangement.<sup>8</sup>

Additional consideration should be given to whether the SC’s conclusions in the Ruling are applicable to the “*deliver-or-pay*” provision where the supplier is required to pay a certain amount to the purchaser in the event of short delivery of the agreed volume of goods. It appears that the parties may agree such provision in their contract by virtue of the freedom of contract principle, and the SC’s conclusions regarding the use of such provision pursuant to the freedom of contract principle can fully be attributed to the “*deliver-or-pay*” arrangement. However, the SC stated in its Ruling that the “*take-or-pay*” arrangement consists of the customer’s right to receive a certain volume of goods and the customer’s obligation to pay for such volume where the “*deliver-or-pay*” arrangement contains two obligations of the supplier—to supply a certain amount of goods and to pay to the purchaser in the event of failure to supply such amount. We assume that the “*deliver-or-pay*” can be structured on the basis of the same principles as the “*take-or-pay*” provision despite the “*deliver-or-pay*” arrangement containing two

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<sup>7</sup> Para. 16 of Ruling No. 54 of the Plenum of the Supreme Court of the Russian Federation on Certain Issues of Application of the General Provisions of the Civil Code of the Russian Federation on Obligations and Performance Thereof dated 22 November 2016.

<sup>8</sup> Ruling of the Judicial Chamber of the Supreme Court of the Russian Federation on Economic Disputes in Case No. 309-ES17-1058, A07-27527/201 dated 28 June 2017.

obligations rather than a right and an obligation as in the “*take-or-pay*” arrangement, however, it remains to be seen whether the court practice would accept such approach.

Therefore, the position of the Supreme Court of the Russian Federation may provide an important guide to drafting and negotiating supply, off-take, services and other agreements governed by Russian law and containing the “*take-or-pay*” or other similar arrangements (including “*deliver-or-pay*”), including to the extent of structuring the obligation to pay in the event of failure to take, the rights of the parties to unilateral repudiation and its consequences; and requiring payment for termination in certain circumstances, etc. However, legal treatment of such terms and conditions in a specific contract should be subject to a separate analysis on the basis of all terms and background facts of the transaction; there is no single approach to structuring that can be applied to all projects.

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Please do not hesitate to contact us with any questions.

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