

DEBEVOISE CORONAVIRUS RESOURCE CENTER

# Spread of COVID-19 and Its Impact on Russian Law Contracts

27 March 2020

The current challenging epidemiologic environment caused by the spread of new coronavirus infection (COVID-19) (“COVID-19”) significantly affects the Russian economy, including the consummation and performance of contracts governed by Russian law.

In this Client Update, we provide a summary of the potential legal consequences of the spread of COVID-19 accompanied by a set of considerations and recommendations in respect of transactions governed by, or currently proposed to be entered into under, Russian law.

On the *Debevoise Coronavirus Resource Center* webpage available [here](#), you will also find regularly updated guidance on various aspects of, and situations related to, the spread of COVID-19 in various foreign jurisdictions, including the United Kingdom,<sup>1</sup> the United States and France.

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<sup>1</sup> You can also find [here](#) our Russian Client Update in respect of consequences of the spread of COVID-19 for contracts subject to English law.

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## General Consequences for Transactions

The spread of COVID-19 has an undeniable impact on both transactions that have been concluded and transactions being negotiated.

For example, there may be new challenges in the way of the proper performance of contractual obligations, including delays in meeting delivery obligations under supply agreements (due to transportation restrictions, closed borders, additional customs and sanitary procedures, etc.). In certain cases, the performance of contractual obligations might be completely impossible altogether, for example, under the contracts that concern the personal performance of obligations by a specific individual who is being quarantined or stopped from entering Russia.

A recently brought action relating to a general meeting of members of an LLC has become one of the first cases highlighting the impact of the spread of COVID-19 on participants in civil law relations. As some of the members were Chinese nationals, and their entrance to Russia was restricted due to the closure of the border between Russia and China, it was impossible to hold a general meeting of the company with its members physically present.<sup>2</sup>

Circumstances such as those aforementioned bring the following questions to the fore in respect of the conclusion and performance of transactions:

- **whether it is possible to terminate a contract** the performance of which has become impeded or impossible (including grounds and procedure of termination);
- **whether it is possible to re-negotiate the terms and conditions of a contract**, including in respect of the period allowed for its performance, price, methods of performance, etc.;
- **whether it is possible to rely on the existing circumstances to secure a release from liability** for the failure to perform or duly perform any obligations; and
- **what caveats and provisions should be included in the terms of proposed transactions** to reduce the risks of various adverse consequences in respect of the performance of contracts in the future in light of the impossibility of predicting (i) the duration of the COVID-19 pandemic or (ii) what measures or actions would

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<sup>2</sup> Ruling of the Federal Arbitrazh Court of the Amur Region, dated 2 March 2020, in Case No. A04-665/2020. See also our [Client Update](#), dated 19 March 2020, dealing with the recently adopted law permitting to conduct any general meetings of shareholders of Russian joint stock companies in the form of absentee voting.

be taken by the competent governmental authorities in connection with the COVID-19 pandemic.

To properly consider and respond to the above questions, it would be helpful, *inter alia*, to have an understanding of whether such elements of the existing circumstances resulted from (i) decisions and/or actions of governmental bodies or (ii) measures taken by the participants in civil law relations on their own initiative, in response to the spread of COVID-19, which may essentially be reasonable and justified but only recommended and not mandatory to comply with for other market participants or their counterparties.

The Civil Code of the Russian Federation (the “Russian Civil Code”) contains four general doctrines that address the above issues: **(i) suspension of performance of the reciprocal obligation;**<sup>3</sup> **(ii) release from liability due to force majeure circumstances;**<sup>4</sup> **(iii) partial or full termination of the obligation due to inability to perform;**<sup>5</sup> **(iv) modification or termination of the obligation due to material change of circumstances.**<sup>6</sup> In addition, there are similar provisions in other rules of the Russian Civil Code that apply to certain specific types of contracts<sup>7</sup> and to those of *lex specialis*.<sup>8</sup>

Below is a description and summary of key differences between the doctrines mentioned above, addressing the impact on the performance of obligations by parties in various transactions.

Ground	Description	Consequences	Procedure
<b>Reciprocal Performance of Obligation</b>	Full or partial failure to perform by the counterparty or evidence that performance will not occur in due time	<ul style="list-style-type: none"> <li>• full or partial suspension of reciprocal performance; or</li> <li>• repudiation of performance of reciprocal obligation;</li> </ul>	Out of court with mandatory notification of the counterparty of the forthcoming suspension or repudiation

<sup>3</sup> Article 328(2) of the Russian Civil Code.

<sup>4</sup> Article 401(3) of the Russian Civil Code. However, this is a discretionary provision of the Russian Civil Code and in the course of the conduct of their business activity, the parties may incorporate in their contract a different definition/list of such circumstances, procedure and consequences of such circumstances and their impact on the transaction or exclude the application of force majeure circumstances to their contract.

<sup>5</sup> Articles 416 and 417 of the Russian Civil Code.

<sup>6</sup> Article 451 of the Russian Civil Code. The parties may provide in the contract that this Article will not apply.

<sup>7</sup> For example, Article 709(6) of the Russian Civil Code in respect of a contractor agreement; Article 620(4)(2) of the Russian Civil Code in respect of a lease agreement.

<sup>8</sup> For example, Article 17 of Federal Law No. 225-FZ on Production Sharing Agreements dated 30 December 1995. In this brief update, we do not separately discuss the rules of the Russian Civil Code governing specific types of contracts or any *lex specialis* rules, however, if you have questions in respect of such contracts and/or legislation, we will be happy to provide their analysis on your request.

Ground	Description	Consequences	Procedure
		and <ul style="list-style-type: none"> <li>right to claim damages</li> </ul>	
<b>Circumstances of Insuperable Force (Force Majeure)</b>	Extraordinary circumstances that could not have been prevented given the situation due to which the proper performance of obligations becomes impossible	<ul style="list-style-type: none"> <li>release from liability during force majeure events; and</li> <li>renewal of contract after the cessation of force majeure events</li> </ul>	Out of court with mandatory notification of the counterparty about the force majeure events with the provision of supporting documents
<b>Inability to Perform Obligations</b>	Insuperable circumstances that have caused objective and ultimate inability to perform obligations in full or in part	Full or partial termination of obligations	Out of court with mandatory notification of the counterparty about the inability to perform
<b>Material Adverse Change</b>	Material change of circumstances on which the parties relied upon the execution of contract	Amendment or termination of contract	<ul style="list-style-type: none"> <li>Out of court by agreement between the parties; and</li> <li>In court by bringing a claim for the modification/ termination of contract</li> </ul>

We discuss certain specific provisions of the above doctrines in more detail below.

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## Reciprocal Performance of Obligation

Reciprocal performance means that the performance of an obligation by one party is conditional upon the performance of the obligations by another party.<sup>9</sup> The parties should verify whether their contracts provide for reciprocal obligations.<sup>10</sup>

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<sup>9</sup> That said, it does not matter whether the parties have set forth the order of performance of their obligations in the contract: see Section 57 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.

Generally, if (i) *one party does not perform its obligations*, or (ii) *there is clear evidence that such party will not perform its obligations on time*, the other party (required to secure reciprocal performance) may suspend or repudiate the performance of its obligations and claim compensation for losses suffered.<sup>11</sup>

Therefore, even if the relevant obligations are not affected by a force majeure event, but are reciprocal in relation to the obligations so affected by such a force majeure event, then, subject to the particular factual background of the transaction, the performance of such obligations may be suspended or terminated.

For example, if a lessor cannot provide access to a leased property to its lessee for any reason, the lessee might, subject to particular factual circumstances, be able to suspend the performance of its obligations under the agreement, including payment of rent.

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## Circumstances of Insuperable Force (Force Majeure)

Generally, a party to a contract will be released from liability if it can show that the proper performance of its obligations is not possible due to a force majeure event, i.e., **extraordinary circumstances that could not have been prevented given the situation**. A review of court practice shows that:

- “**extraordinary**” means exceptional, beyond “normal” or ordinary, unusual for certain living conditions that does not relate to life risk or cannot be taken into account under any circumstances;<sup>12</sup> that “**could not have been prevented**” means the effect of objective factors impeding the performance of an obligation imposed on an individual or a legal entity,<sup>13</sup> or a circumstance, the occurrence of which or its consequences could not have been avoided by any participant in civil law relations engaged in activities similar to those of the debtor;<sup>14</sup>

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<sup>10</sup> Provisions of Article 328(2) of the Russian Civil Code may apply regardless of which party is required to perform its obligations first: “if a party required to deliver first under a contract identifies evidence listed in Article 328(2) of the Civil Code of the Russian Federation it may also seek relevant remedies.” (Overview of Court Practice of the Supreme Court of the Russian Federation No. 4 (2019) approved by the Presidium of the Supreme Court of the Russian Federation on 25 December 2019).

Reciprocal performance may be envisaged by law, see, e.g., Articles 51.3(16), 51.3(16.1) of Federal Law No. 39-RZ on the Securities Market, dated 22 April 1996, in respect of repo agreements.

<sup>11</sup> Article 328(2) of the Russian Civil Code.

<sup>12</sup> Ruling of the Presidium of the Russian Higher Arbitrazh Court No. 3352/12 in Case No. A40-25926/2011-13-230 dated 21 June 2012.

<sup>13</sup> Ruling No. AKPI12-69 of the Supreme Court of the Russian Federation dated 14 March 2012.

<sup>14</sup> Ruling No. 7 of the Plenary Session of the Supreme Court of the Russian Federation dated 24 March 2016.

- the onset of force majeure circumstances does not terminate the obligation of the debtor as such if the performance remains possible after their cessation; and
- a creditor remains entitled to repudiate the contract if the delay caused by the force majeure circumstances made the creditor lose interest in the performance.<sup>15</sup>

The party relying on a force majeure event may, for example, for the purposes of proving the onset of such circumstances:

- obtain a “force majeure certificate” issued by the Chamber of Commerce and Industry of Russia in accordance with the established procedure;<sup>16</sup> and
- refer to the admission of such circumstances by governmental authorities.

For example, pursuant to the Decrees of the Mayor of Moscow<sup>17</sup> *the spread of COVID-19 is an extraordinary event that could not have been prevented which led to the imposition of a high-alert regime which is a force majeure event*. These Decrees extend to the relations of the parties in the performance of their obligations in Moscow only. We note that the Decrees of the Mayor of Moscow do not make it entirely clear which circumstance is recognised as a force majeure event, which is important for the qualification of the relations between the parties. In particular, it is not clear (i) whether the spread of COVID-19 as such is a force majeure event (and, in such case, it will have an impact on the obligations of persons who have been officially confirmed as infected with COVID-19)<sup>18</sup> or (ii) whether the imposition of the high-alert regime is a force majeure event (and, in this case, compliance with the imposed measures, if it temporarily renders the performance of obligations impossible, may serve as a ground for release from liability for the failure to perform such obligations).

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However, extraordinary circumstances that could not have been prevented cannot include, in particular, breach of obligations by the debtor’s counterparties, unavailability of goods required for the performance on the market or lack of necessary funds.

<sup>15</sup> Ruling No. 7 of the Plenary Session of the Supreme Court of the Russian Federation dated 24 March 2016.

<sup>16</sup> The Regulations on the Procedure of Certification of Force Majeure Circumstances by the Chamber of Commerce and Industry of the Russian Federation (Annex to Resolution No. 173-14 of the Management Board of the Chamber of Commerce and Industry of the Russian Federation dated 23 December 2015).

<sup>17</sup> Article 13 of Decree of the Mayor of Moscow No. 21-UM0 on Amendment of Decree of the Mayor of Moscow No. 12-UM dated 5 March 2020 and Article 16 of Decree of the Mayor of Moscow No. 31-UM on Amendment of Decree of the Mayor of Moscow No. 12-UM dated 5 March 2020.

<sup>18</sup> The Bank of Russia, for example, has recommended in its [approved measures](#) for the support of citizens, economy and finance sector during the coronavirus pandemic that lending institutions and microlenders do not seek to enforce their claims against the immovable property securing the obligations of individual borrowers who have breached their obligations upon the provision of official confirmation that such borrowers were infected with COVID-19.

Certain governmental authorities have also issued guidance relating to the spread of COVID-19, for example:

- the Russian Ministry of Finance has announced that, subject to certain circumstances, Russian entities may be exempted from administrative penalties for delayed repatriation of currency revenues due to force majeure circumstances resulting from measures taken by foreign governments to combat the spread of COVID-19;<sup>19</sup> and
- FAS Russia has noted that the COVID-19 pandemic is a force majeure event and therefore certain types of goods, works and services may be procured by a single supplier.<sup>20</sup>

It should be borne in mind that the recognition of the onset of force majeure circumstances due to the spread of COVID-19 by the Mayor of Moscow or other governmental bodies do not, by themselves, have legal effect, for example, of releasing parties from (i) ***the proper performance of obligations*** or (ii) ***liability for the failure to perform or to duly perform the obligations***.

The parties must show **how the occurrence of a force majeure event affects their contract** and their ability to perform all or part of their obligations thereunder. This is because the force majeure circumstances may or may not have sufficient effect on the proper performance of such obligations depending of the nature, place, time and method of performance of the relevant obligation. For example, as confirmed by earlier court practice, the performance of monetary obligations is not affected by force majeure, and, therefore, debtors cannot claim that the onset of such force majeure circumstances had caused their inability to meet their payment obligations.<sup>21</sup>

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## Inability to Perform Obligations

The circumstances occurring after the execution of the contract and preventing the performance of any contractual obligation must meet, among other things, the following criteria:

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<sup>19</sup> [Information Letter](#) of the Ministry of Finance of the Russian Federation dated 20 March 2020.

<sup>20</sup> [Guidance](#) of FAS Russia dated 18 March 2020.

<sup>21</sup> Ruling of the Higher Arbitrazh Court of the Russian Federation No. VAS-5118-14 in Case No. A63-8547/2013 dated 29 April 2014.

- the action constituting the essence of the obligation **cannot be objectively performed by any person**,<sup>22</sup>
- the circumstances are not predicated upon the actions of the parties;
- be insurmountable (*with reference to Article 401(3) of the Russian Civil Code*); and
- be persistent, i.e., indefinite as to the duration of their effect.

However, if the inability to perform arose during the debtor's delay in performance, the debtor shall be liable for any losses caused to the creditor.<sup>23</sup>

For example, certain cinema chains had to limit or cancel cinema shows due to the spread of COVID-19 and acts and recommendations issued in this connection by the governmental authorities.

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## Material Adverse Change

Over the life of a contract, the occurrence of a “material adverse change” does not necessarily reflect a situation where the performance of contractual obligations becomes impossible. However, the performance of such obligations without further modification of the terms of the contract is likely to significantly prejudice the interests of one or more parties and may cause substantial damage to an interested party, effectively depriving it of any benefits that it was contemplated to be entitled to over the life of the contract at the time the contract was entered into. It is important to note that the material adverse change must have occurred **after the execution of the contract** and that, **at the time of its execution, there were no facts, events or circumstances** that the parties were, or should have been, aware of and should have considered when entering into the contract.

In practice, the concept of material adverse change is one of the most difficult to rely upon due to the high standards set by Russian legislation for its application, the requirement to carry out a comprehensive examination of many facts and, in most cases, an absence of a coherent approach in court practice of the rules regarding the concepts of material adverse change, “inability” to perform obligations and force majeure.

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<sup>22</sup> Ruling of the Judicial Chamber of the Supreme Court of the Russian Federation on Economic Disputes in Case No. 305-ES16-14210, A40-85057/2015 dated 30 January 2017.

<sup>23</sup> Article 405(1) of the Russian Civil Code.

The development of the court practice shows that the following events, amongst other events, do not constitute material adverse changes:

- financial turmoil or worsening of economic climate;<sup>24</sup>
- changes in the exchange rates;<sup>25</sup> and
- high inflation rates.<sup>26</sup>

For example, in the real estate context, subject to meeting all the criteria and supporting the onset of circumstances listed in Article 451 of the Russian Civil Code, a lessee may require modifications to or termination of a lease agreement in respect of a land plot on which a retail and entertainment centre is located if a portion of such land plot is designated for the construction of an infectious diseases hospital for confirmed COVID-19 patients.

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## Practical Recommendations

### Concluded Transactions

It is our recommendation that parties whose performance of contractual obligations might be impacted by the COVID-19 pandemic and counterparties of such parties carefully review the terms and conditions of their contracts and evaluate the risks and potential consequences they might face if any force majeure circumstances arise. In particular, some key considerations when evaluating such potential consequences include:

- **in respect of reciprocal performance of obligations**—it is important to determine (i) which obligations in the contract are reciprocal and (ii) in what way the circumstances that have arisen and the failure to perform its obligations by the counterparty can impact the ability to perform or suspend the performance of reciprocal obligations by the other party to the transaction;
- **in respect of force majeure**—to be able to rely on force majeure, it will be necessary to assess whether the effect of the relevant circumstances is temporary or permanent and how that would affect the performance of obligations in the context of a

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<sup>24</sup> See Ruling No. 14265/09 of the Presidium of the Russian Higher *Arbitrazh* Court dated 2 March 2010.

<sup>25</sup> Ruling No. 18-KG16-102 of the Supreme Court of the Russian Federation dated 13 September 2016.

<sup>26</sup> Ruling of the Presidium of the Russian Higher *Arbitrazh* Court No. 1074/10 in Case No. A40-90259/08-28-767 dated 13 April 2010.

particular transaction. It will then be necessary to (i) prove that those circumstances are extraordinary and insurmountable and (ii) establish the impact on the performance of such obligations under the transaction;

- **in respect of an inability to perform obligations**—the parties will have to show that their situation is different from a force majeure (which is temporary as regards the onset of the circumstances), and if it is established that the relevant circumstances are not temporary, the parties may be entitled to terminate their obligations under the transaction; and
- **in respect of material adverse change** – certain aspects of the situation that has occurred may constitute a material adverse change. However, the standards of proving for the application of Article 451 of the Russian Civil Code are high, and the claimants seeking to invoke this Article are rarely successful in courts and it is necessary to follow the development of the court practice to determine whether this concept is applicable to the circumstances that have arisen under the particular agreement.

In addition, a determination of impact of the COVID-19 pandemic on a transaction will require an evaluation of (i) the totality of agreements made between the parties governing their relations, including security documents, and (ii) other agreements, including those with other counterparties where the failure to perform their obligations may affect the performance under the transaction in question as, for example, recognition of certain circumstances as force majeure under the principal transaction may have certain legal consequences for other transactions related to it (*cross-default provisions*).

## Future Transactions

In the current situation, when negotiating a transaction, it is important that the parties pay attention to the following matters:

- if the parties intend to ensure flexibility and predictability of their relations and minimise the effect of various external circumstances, the parties may (i) include various provisions in the force majeure clause related to the further spread of COVID-19 and its impact on the potential transaction;<sup>27</sup> (ii) set forth grounds for the unilateral repudiation of the transaction in the event of an onset and/or continued effect of certain events specified in the agreement (including the spread of COVID-19); (iii) agree to a mechanism for the unilateral modification of certain terms of the

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<sup>27</sup> Please note that on 25 March 2020, the International Chamber of Commerce – World Business Organisation (ICC) [made amendments](#) to its standard Force Majeure and Material Adverse Change Clauses (*ICC Force Majeure Clause*).

agreement; (iv) specify, as a remedy, the ability to recover material losses (indemnity) (Article 406.1 of the Russian Civil Code) caused by various events and acts of governmental authorities related to the spread of COVID-19; and

- if the parties intend to establish a rigid obligation to be performed regardless of external circumstances, the parties may (i) expressly exclude the COVID-19 pandemic and/or related acts of governmental authorities from the contractual list of force majeure circumstances as well as agree to other terms and consequences of the impact of the spread of COVID-19 on the legal relations between the parties within the framework of a specific transaction and (ii) expressly exclude the application of Article 451 of the Russian Civil Code (i.e., relating to the consequences in the event of a material adverse change).

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Please do not hesitate to contact us with any questions.

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