

COVID-19: Legal Impact on Contractual Obligations

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The spread of the coronavirus infection (2019-nCoV) is causing parties to consider the need to amend or cancel their contracts. They will also likely be giving thought to the allocation of liability and expenses in connection with non-performance or threatened non-performance. This overview covers the steps parties can or must take in order to resolve such matters as well as the legal principles involved.

General regulatory measures, such as the announcement of the high alert regime, are unlikely to affect a party's ability to perform its contractual obligations. "Special measures", however (such as a ban on mass events, the temporary suspension of a business' work, restrictions on entry into the Russian Federation, the cessation of air operations, etc¹), may prevent a party from performing its contractual obligations. Special measures enacted by foreign states may also have the effect of preventing a party from performing such obligations, for example in the context of a contract for the supply of goods from abroad.

The following legal principles may apply in the event that special measures affect the performance of contractual obligations:

- impossibility of performance of an obligation (Art. 417 of the RF Civil Code);
- force majeure (clause 3 of Art. 401 of the RF Civil Code);
- material change of circumstances (Art. 451 of the RF Civil Code).

The nature of the obligation, and the period within which it must be performed, will affect the application of these principles. Likewise, the extent to which the special measures affect the performance of the relevant obligation will likely determine which of these principles applies. Where the special measures make performance completely impossible, the obligation will be terminated by operation of law. Where the special measures make it only temporarily impossible to perform an obligation, a force majeure event occurs. If it becomes difficult, but still possible, to perform an obligation, the affected party can engage the principle of a material change of circumstances, subject to the factors considered below. These principles will apply so long as the obligation remains in force (and has not yet been breached) at the time the special measures are announced.

¹ The current special measures are dealt with in more detail in our News Bulletin "COVID-19: Russian Legal Impact", March 2020. <https://www.whitecase.com/sites/default/files/2020-03/COVID-19-russian-legal-update-eng.pdf>

Impossibility of performance of an obligation (Art. 417 of the RF Civil Code)

The affected party must notify the other party, in good faith, when it becomes impossible to perform an obligation.² If the obligation is terminated on this ground, the creditor cannot claim damages from the debtor.³ Any consideration provided under the contract before the termination of the obligation, must be returned on the basis of the unjust enrichment rule.⁴

An example of this principle would be the cancellation of a conference, exhibition or other mass event as a result of a prohibition on large gatherings of people. In this case, the organizer of the event would have to refund any payments made by participants, after deducting any expenses the organizer has already incurred.

Parties can agree amongst themselves to postpone an event. Where the organizer has the right to postpone an event, and has taken advantage of that right, the principle of impossibility of performance will not apply.

Force majeure (clause 3 of Art. 401 of the RF Civil Code)

Force majeure occurs where there are extraordinary and unavoidable circumstances.⁵ Circumstances recognized in practice as force majeure include acts of God, as well as governmental bans, bans on trade operations (including a ban on trade operations in or with certain countries) resulting from international sanctions, and other circumstances outside of the control of the parties to the contract.⁶

At the same time, some circumstances, however extraordinary, do not qualify as force majeure:

- a breach on the part of the debtor's contracting partners, unavailability of goods required for the performance of the contract, or the absence of necessary cash amounts at the disposal of the debtor;⁷
- reduced number of customers due to anti-virus measures;⁸
- employee remote working because of anti-virus measures;⁹
- a surge in currency rates.¹⁰

The impact of force majeure on contractual performance may not be clear cut. This can be the case, for example, in the event that a specific component required for the assembly of equipment cannot be supplied due to extraordinary and unavoidable circumstances, such as the closure of the borders or special measures introduced by foreign states. In addition, because of the dynamic and nonlinear character of force majeure circumstances, and the effects thereof, each special measure can become a force-majeure event, either alone or in combination with other measures.

In order to be released from liability, the party must show that its inability to perform an obligation results directly (as opposed to indirectly) from the force majeure event. Furthermore, they must show that the impact of the force majeure event could not have been foreseen at the time the contract was entered into and could not otherwise be overcome. For instance, a person who should have been aware that measures such as product embargoes or border closures may be introduced (and who could have purchased similar goods from

² Clause 3 of Art. 307 of the RF Civil Code.

³ Section 23 of the Resolution by the Plenum of the RF Supreme Court No. 7 dated 24 March 2016.

⁴ Paragraph 2 of clause 4 of Art. 453 of the RF Civil Code.

⁵ Section 8 of the Resolution of the Plenum of the RF Supreme Court dated 24 March 2016 No. 7.

⁶ Section 1.3 of the Regulation on the Procedure for Certification of Force Majeure by the Chamber of Commerce and Industry of the Russian Federation (annex to Resolution of the RF CCI Board dated 23 December 2015 No. 173-14).

⁷ Article 401.3 of the RF Civil Code.

⁸ Answers of the RF CCI to questions about force majeure of 24 March 2020.

⁹ Answers of the RF CCI to questions about force majeure of 24 March 2020.

¹⁰ Answers of the RF CCI to questions about force majeure of 24 March 2020.

within the country) would not be able to rely on force majeure in order to avoid contractual liabilities relating to such products.¹¹

Therefore, if a party enters into a contract in the present circumstances, despite the probability that additional special measures will be introduced which may render performance of the contract impossible, that party would not be able to rely on force majeure. Moreover, the parties cannot extend, of their own will, the list of force majeure circumstances in the contract and recognize as force majeure situations which in fact are not extraordinary and unavoidable.¹²

Legal impact of force majeure

A debtor will not be liable for breaches of contract resulting from a force majeure event. The occurrence of force majeure does not terminate the debtor's obligation if performance remains possible after the force majeure ceases to have effect.¹³ The obligation to perform is suspended for the duration of the force-majeure event and is resumed once the force majeure event is no longer in operation. Contracts can provide for specific consequences resulting from the occurrence of force majeure, such as the automatic termination or extension of obligations.

Where, due to the length of a force majeure, a creditor no longer wants the contract to be performed, it may repudiate the contract.¹⁴ A creditor may decide not to repudiate the contract after an event of force majeure, but then later decide to repudiate the contract after the introduction of certain additional measures. There is no prescribed period in law within which the creditor must repudiate the contract (although such period may be provided for in the contract).

Material change of circumstances (Art. 451 of the RF Civil Code)

Where there is a material change of circumstances, an affected party can demand that the contract is either amended or terminated. In the event that the parties are unable to reach agreement, an affected party may seek the amendment or termination of the contract in court to resolve the disagreement.

This principle is supplemented by special provisions of law, which allow the amendment or termination of certain contracts either in the absence of all the conditions prescribed by Article 451 of the RF Civil Code or in other specified circumstances. For example, in respect of construction contracts, if there is a significant increase in the cost of materials, equipment and third-party services, which could not have been foreseen when the contract was signed, the contractor can request a price increase, and, if the customer refuses to fulfil this request, terminate the contract.¹⁵ Moreover, the contractor must notify the customer of any circumstances outside of its control that make timely completion of the works impossible, and, if no instructions as to changing the work procedures are received from the customer, the contractor can terminate the contract and claim damages.¹⁶

Similar situations with regard to leases are regulated by Article 614 of the RF Civil Code, pursuant to which the lessee is not obliged to pay rent for the period in which it is unable to use the leased object due to circumstances outside of its control.¹⁷

Article 451 of the RF Civil code contains the following provision: "*performance of the contract without amending its provisions would so much upset the balance of the property interests of the parties corresponding to a specific contract, and would entail such a loss for the affected party that it would be largely deprived of what it could have expected when concluding the contract*". This often causes the greatest difficulty to parties seeking to prove that there has been a material change of circumstances.

¹¹ Resolution of the FAS of the North-Western District dated 27 June 2014 No. F07-6569/2013.

¹² Resolution of the FAS of Moscow District dated 8 June 2007 r. No. KG-A40/2771-07.

¹³ Section 9 of the Resolution of the Plenum of the RF Supreme Court dated 24 March 2016 No. 7.

¹⁴ Section 9 of the Resolution of the Plenum of the RF Supreme Court dated 24 March 2016 No. 7.

¹⁵ Clause 6 of Art. 709 of the RF Civil Code.

¹⁶ Art. 716 of the RF Civil Code.

¹⁷ Section 4 of the Case Law Digest of the RF Supreme Court No. 2 (2015) approved by the Presidium of the RF Supreme Court dated 26 June 2015, Section 5 of the Case Law Digest of the RF Supreme Court No. 3 (2017) approved by the Presidium of the RF Supreme Court dated 12 July 2017.

If a party requests an amendment rather than termination, they must prove that termination of the contract would be contrary to public interest or would result in damage to the parties that would considerably exceed the expenses required for the performance of the contract on the terms amended by the court.¹⁸

This principle may be engaged in the present circumstances. For example, it may apply as a result of a deficit of certain foreign goods resulting from a ban on the import of such goods from certain countries. In such a situation, the relevant party must prove that, although it is still possible to perform the obligation under the contract for the supply of such goods, it would be very difficult or expensive.

Practical steps

- In the event that special measures affect the performance of contractual obligations, parties should first seek to understand which of the above principles is likely to apply to the legal relations between them, and analyze possible performance alternatives.
- It will also be necessary to undertake an objective assessment of the cause of the non-performance. This is because release from liability is only available where the special measures directly cause the circumstances that make it impossible to perform the relevant contractual obligations.
- The parties should check whether the contract or the law make special provision for the present circumstances, such as the possible postponement of obligations or price adjustment in connection with such unforeseen circumstances or circumstances outside of the parties' control.
- The other party should be notified promptly, and in any case within any time limits provided for in the contract, about the fact that the contract has become impossible to perform, about the difficulties in performing the relevant obligation, or about the occurrence of force majeure.
- It would be prudent to suggest different options to the other party, after making a preliminary estimate of the parties' losses and expenses as a result of each option.
- It is advisable to determine whether the parties are interested in maintaining contractual relations, and, if such interest remains, to obtain written confirmation of this intention from the other party.
- Parties should take reasonable steps to mitigate their own and the other party's losses.
- We would advise that parties retain evidence, in the event that any dispute has to be settled in court, especially if the circumstances involved are complex. Such evidence can include acts of Russian and foreign authorities, media news, notices from contracting partners, etc.
- For the purposes of proving force majeure occurring in Russia, one can apply for a Force Majeure Certificate to the CCI of Russia in respect of a foreign trade contract, and to the CCI of the relevant constituent entity of the Russian Federation in respect of a Russian contract. This certificate is likely to be useful in the event that the parties have assigned special evidential significance to it in the contract.

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¹⁸ Clause 4 of Art. 451 of the RF Civil Code.