

Newsletter

The impact of the coronavirus (COVID-19) on performance of contractual obligations

March 25, 2020

Dear Ladies and Gentlemen,

The coronavirus (COVID-2019)¹, which today affects more than 150 countries and territories around the world, has already had, and continues to have, a significant impact on the global economy.

In such circumstances, Russian business inevitably faces, on the one hand, the need to comply with the epidemiological requirements and restrictions imposed by the Russian and foreign public authorities, and, on the other hand, with the problems of performance of its current obligations, including foreign trade contracts.

In this information letter, we have aimed to touch upon the most relevant issues of the legal consequences of the coronavirus, for current and future Russian law contracts.

1 Excused from performance of the obligations, or from liability for the breach of the obligations, in connection with the coronavirus

1.1 Force majeure

In accordance with paragraph 3 of article 401 of the Civil Code of the Russian Federation, force majeure is an extraordinary, and objectively unavoidable, circumstance under the current conditions, the occurrence of which excludes liability for the breach, or non-performance, of the obligations.

To exclude liability of the debtor for non-performance of the obligations, it is necessary to prove that the inability to perform the respective obligations was caused by force majeure, that is, in this case, the coronavirus and/or restrictive measures taken in connection with its spread.

Judicial practice considers epidemics and pandemics as force majeure². The current legislation³ understands the term "epidemic" as infectious diseases that pose a threat to others, that is, human infectious diseases characterized by severe acute disease, a high mortality rate and disability, together with the rapid spread of the disease among the population. The Government of the Russian Federation approved the list of such diseases⁴. The coronavirus (2019-nCoV) is included in this list⁵.

It should be noted that, in connection with the spread of the coronavirus, individual regions of the Russian Federation introduced a high-alert regime and established a number of restrictions on entrepreneurial activity. On March 5th 2020, the Mayor of Moscow issued a Decree No. 12-UM "On the introduction of a high-alert regime" (hereinafter "**Decree No. 12-UM**"), which established special measures to prevent the spread of the coronavirus in Moscow.

¹ On March 11, 2020, the World Health Organization announced that the spread of the new coronavirus (COVID-19) had reached the stage of a pandemic.

² The decision of the Supreme Arbitration Court of the Russian Federation of May 03, 2012 No. VAS-3352/12 in the case No. A40-25926 / 2011-13-230; The decision of the Arbitration Court of the Ural District of February 6, 2019 No. Ф09-8477 / 18 in the case No. A76-30210 / 2016; The decision of the Arbitration Court of the Far Eastern District of August 27, 2019 No. Ф03-3458 / 2019 in the case No. A04-9007 / 2018; The decision of the Arbitration Court of the Moscow District of April 01, 2016 No. F05-1154 / 2016 in the case No. A40-97911 / 15-121-785.

³ Paragraph 17 of article 1 of the Federal Law of March 30, 1999 No. 52-FZ "On the medical and epidemiological welfare of the population".

⁴ Decree of the Government of the Russian Federation of December 1, 2004 No. 715 "On approval of the list of socially significant diseases and the list of diseases that pose a threat to others".

⁵ Decree of the Government of the Russian Federation dated January 31, 2020 No. 66 "On Amending the List of Diseases that pose a threat to others".

Decree No. 12-UM includes mandatory self-isolation at home for arrivals from the certain countries and a number of other restrictions.

On March 14th 2020, Decree No. 12-UM was amended and the spread of the coronavirus (2019-nCoV) was recognized as an extraordinary and unavoidable circumstance, which led to the introduction of the high-alert regime, which, in turn, is a force majeure⁶.

A similar provision is contained in Resolution of the Governor of the Moscow Region of March 12, 2020 No. 108-PG, which introduced the high-alert regime on the territory of the Moscow Region (amended by the Resolution of March 13, 2020 No. 115-PG).

These normative acts do not qualify the spread of coronavirus itself as a force majeure, but the high-alert regime introduced by public authorities of the regions of the Russian Federation to prevent such spread.

As of March 19th 2020, the high-alert regime was introduced throughout the Russian Federation⁷.

At the federal level, neither this regime, nor the coronavirus, was recognized as a force majeure. Moreover, according to current case law, unlike a state of emergency, such regime determines only the activities of public authorities and is not sufficient in itself to be qualified as a force majeure⁸.

At the same time, in an attempt to help businesses out of the crisis, federal authorities and non-governmental associations are adopting acts and explanations that allow parties to qualify the coronavirus as a force majeure, in certain circumstances.

In particular, at the moment, the Ministry of Finance of the Russian Federation and the Federal Antimonopoly Service of the Russian Federation have issued clarifications on the recognition of the coronavirus as a force majeure in public procurement⁹ (the corresponding act is also being prepared at the level of the Government of the Russian Federation¹⁰), and the Chamber of Commerce and Industry of the Russian Federation is already issuing certificates of force majeure due to the coronavirus, in cases of disruption of export contracts. In addition, the Ministry of Finance of the Russian Federation requests not to prosecute residents who cannot ensure the timely repatriation of foreign exchange earnings, due to force majeure circumstances, including due to the measures taken by foreign governments to prevent the spread of the coronavirus¹¹, and the Ministry of Economic Development of the Russian Federation has prepared a bill, according to which, the government will have the right to introduce a moratorium on initiating bankruptcy cases of organizations in an emergency of natural, or man-made, disasters, as well as significant changes in the rate of the ruble¹².

Nevertheless, the quarantine measures have not been fully introduced by the Russian public authorities, so, the question of inability to perform obligations in connection with the epidemic, or current, restrictions will be decided by the court, on a case-by-case basis.

1.2 Objective inability to perform obligations

Force majeure excludes liability for breach of an obligation, but does not terminate it. Unlike force majeure, if there is an objective inability to perform an obligation, it terminates automatically (paragraph 1 of article 416 and article 417 of the Civil Code of the Russian Federation).

Inability to perform obligations should be caused by the circumstance that occurred after the obligation had arisen, for which neither of the parties is responsible¹³ (for example, an act of a public authority, or local government, that establishes epidemiological restrictions).

⁶ Paragraph 1.6 of the Decree of the Mayor of Moscow of March 14, 2020 No. 20-UM "On Amendments to the Decree of the Mayor of Moscow dated March 5, 2020 No. 12-UM".

⁷ A source: <https://tass.ru/obschestvo/8027563>

⁸ The decision of the Sixth Arbitration Court of Appeal of January 29, 2020 in the case No. A04-3320 / 2019.

⁹ The letter of the Ministry of Finance of the Russian Federation of March 03, 2020 No. 24-06-06 / 21324 "On the procurement of a sole supplier (contractor, executor) upon introducing a high alert". <https://fas.gov.ru/news/29575>

¹⁰ A source: <http://kommersant.ru/doc/428.3265>

¹¹ https://www.minfin.ru/ru/document/?id_4=129865-informirovanie_uchastnikov_vneshnyekonomich-eskoi_dyeyatelnosti_v_svyazi_s_rasprostraneniem_novoi_koronavirusnoi_infektsii_covid_2019_o_nyeobkhodimyykh_deistviyakh_dlya_nepriv.

¹² A source: <https://regulation.gov.ru/projects#npa=100548>

¹³ Article 416 of the Civil Code of the Russian Federation (part one) of November 30, 1994 No. 51-FZ (hereinafter - the "Civil Code of the Russian Federation").

Inability to perform obligations must be factual, objective and final (permanent)¹⁴.

Accordingly, acts of public authorities and local government adopted to prevent the spread of the coronavirus, and obstructing the performance of the contracts, can be qualified by the courts as a basis for terminating the relevant obligations.

1.3 Material change of circumstances

If, due to the spread of the coronavirus, the circumstances have changed so much that, if the parties could reasonably foresee it, they would not have concluded the contract at all, or would have concluded it on significantly different conditions, the court, at the request of the party to the contract, has the right to terminate, or amend, the terms of the contract, due to material change of circumstances (article 451 of the Civil Code of the Russian Federation).

To satisfy the claim for amendment, or termination, of the contract, the party must prove the existence of the conditions listed in paragraph 2 of Article 451 of the Civil Code of the Russian Federation, in particular, the insuperability of the changes and an imbalance between the property interests, in the case of the further performance of the contract, in its original form.

Regarding the qualification of the epidemic as a material change in circumstances, judicial practice cannot rely on numerous cases¹⁵, but this should not become an obstacle to the application of this concept to the current situation.

2 Contractual instruments to reduce the risk of non-performance of obligations

The rapid spread of the coronavirus, and the significant amount of measures taken at the state level around the world, objectively compels market players to pay more attention to the content of contracts, to ensure the proper performance of obligations and the potential risk allocation associated with its non-performance.

We can recommend considering use of the following contractual instruments, which help the parties to ensure legal certainty in case of unforeseen situations, during the performance of the contract.

2.1 Force majeure clause and a concept of material change of circumstances

It should be borne in mind that paragraph 3 of article 401 and article 451 of the Civil Code of the Russian Federation are dispositive law. This means that the parties have the right both to exclude the application of these articles to the concluded contract, and to regulate them additionally by their contract (for example, to provide deadlines for notification of the occurrence of force majeure events, or to agree on the procedure for the provision of evidence of the occurrence of a force majeure).

However, it is important to understand that the absence of a clause on force majeure, or a material change of circumstances in the current contract, does not indicate the impossibility of their use in the current circumstances.

2.2 Indemnity (article 406.1 of the Civil Code of the Russian Federation)

The spread of the coronavirus leads to restrictions on air and rail traffic, trade restrictions and prohibitions, which involve significant extra costs and losses for one, or for each, side. Such losses may be, for example, losses caused by the inability to perform obligations, the submission of claims by third parties, or public authorities, etc.

The parties are entitled to provide for a procedure for compensating such extra costs through the mechanism of indemnity¹⁶.

Unlike the compensation of losses under the rules of articles 15 and 393 of the Civil Code of the Russian Federation, indemnity under the rules of article 406.1 of the Civil Code of the Russian Federation applies if there is no breach of the obligations by the relevant party, and regardless of the causal relationship between the behavior of that party and the losses subject to compensation¹⁷.

¹⁴ The decision of the Judicial College on Economic Disputes of the Supreme Court of the Russian Federation of January 30, 2017 in the case No. 305-ES16-14210, A40-85057 / 2015.

¹⁵ The decision of the Arbitration Court of the Central District of August 14, 2015 No. F10-2685 / 2015 in the case of No. A35-8264 / 2014.

¹⁶ Article 406.1 of the Civil Code of the Russian Federation.

¹⁷ Paragraph 15 of Resolution of the Plenum of the Supreme Court of the Russian Federation of March 24, 2016 No. 7 "On the application by courts of certain provisions of the Civil Code of the Russian Federation on liability for the breach of the obligations".

Both the indication in the contract of any specific amount of indemnity and the procedure for its calculation are acceptable.

2.3 Unilateral termination of contract

In addition to indemnity, the parties are entitled to provide for the right to unilaterally terminate the obligation, which is also one of the ways to minimize the risks associated with the consequences of the coronavirus. In most cases, termination fees may apply.

2.4 Unilateral modification of contract

If parties do not want to include the right to a unilateral refusal to continue with the contract, or the other party does not agree to enter into the contract on similar conditions, it is possible to provide for the right to unilaterally change specific terms of the contract (for example, event or delivery date change).

Thus, there is currently a high level of uncertainty regarding operations under the existing contracts, performance of which may be questionable, or impossible. Companies need to closely monitor the development of the situation around the coronavirus, the laws adopted in connection with it and quickly respond to changing circumstances, including by amending the existing contracts that the parties intended to perform in other circumstances, or terminating them timely. It should be kept in mind that the actions of the parties, in any case, must comply with the principles of reasonableness and good faith.

We hope that the information provided herein will be useful for you. If any of your colleagues would also like to receive our newsletters, please send them the link to complete a [Subscription Form](#). If you would like to learn more about our [Dispute Resolution](#) and [Commercial law](#) practice areas, please let us know in reply to this email. We will be glad to provide you with our materials.

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