Impact of the Supreme Court Presidium Review of the application of COVID-19 regulations on lease relations

April 2020

The Supreme Court of the Russian Federation (the **Supreme Court**) on April 21, 2020, published a review of court practice of applying laws and measures to prevent the spread of COVID-19. The key issues deal with how to apply procedural, civil, criminal and administrative legislation, as well as bankruptcy laws (the **Review**).

In this alert we provide our analysis of the Supreme Court's clarifications presented in the Review on the most interesting and frequently discussed issues in recent days: whether **restrictions can be deemed force majeure or grounds for termination or amendment of a contract,** and **the legal framework of the "non-working days"** in the context of deadlines for performing obligations. In particular, we analyze some of the clarifications in the context of *lease agreements*.

Analysis of the Review shows that the Supreme Court has brought much uncertainty to established statutory concepts. As you may recall, after the last crises in 2008 and 2014, the Russian courts took the consistent approach that the parties' arrangements set forth in signed contracts could not be changed (for example, in most cases citing force majeure or a material change in circumstances was rejected). This leant stability to commerce. However, now that the Supreme Court has cast doubt on established approaches without having provided concise clarifications as to how they should be applied in future, it is difficult to understand how to interpret most situations that arise in practice from the legal perspective.

Question: Can the epidemiological situation, restrictions or self-isolation policy be deemed force majeure (Article 401(3) of the RF Civil Code) or grounds to terminate an obligation due to inability to perform it (Article 416 of the RF Civil Code), including due to an act of a state authority (Article 417 of the RF Civil Code), and, if it is possible, under what conditions?

In its Review the Supreme Court once again repeated the basic provisions of RF Supreme Court Plenum Resolution No. 7 of March 24, 2016, with regard to whether circumstances can be deemed force majeure and also gave the following clarifications:

A. **A pandemic being deemed force majeure cannot be universal for all categories of debtors** and depends on their type of activity and the conditions of that activity, including the region where the organization operates. Therefore, whether force majeure exists should be determined considering the facts of a specific case.

   In order to be released from liability for failure to perform its obligations a party must prove:

   - The existence and duration of force majeure
   - A **cause-and-effect relationship between the force majeure and the inability or delay in performing the obligations**
   - The party was not involved in creating the force majeure
   - The party, acting in good faith, took steps reasonably expected to prevent (mitigate) the possible risks

Dentons' comment: *The restrictions currently applied are not automatic grounds for release from liability under any concluded contract. In other words, the fact of force majeure must be proven in each specific case subject to the criteria mentioned above.*

B. Although Article 401(3) of the RF Civil Code explicitly states that lack of funds does not constitute force majeure, **if lack of the necessary funds is caused by the established restrictions**, in particular a ban on certain activity, the introduction of a self-isolation policy, etc., **then it can be deemed a ground for release from liability** for nonperformance or improper performance of obligations under Article 401 of the RF Civil Code. Release from liability is allowed if a reasonable and prudent business party engaging in activity similar to that of the debtor could not have avoided the unfavorable financial consequences caused by the restrictions (for example, if there is a significant decrease in profit due to the forced closure of a food service establishment to the public).

Dentons' comment: *This is one of the most important clarifications. If the debtor proves that the lack of funds was related to the restrictions put in place, then the debtor cannot be denied release from liability for nonperformance merely on the ground that Article 401(3) explicitly excludes "lack of funds" from the grounds for release from liability. This clarification essentially signifies a change in the previous approach where the courts consistently declined to deem a debtor's lack of funds (whatever the reason) force majeure.*

C. Documents (e.g., findings, certificates) issued by the competent authorities and confirming force majeure **may be taken into consideration** when examining whether to release someone from liability as a result of force majeure.

Dentons' comment: *As we have already noted, having a certificate from a chamber of commerce is not a conclusive ground to not perform an obligation counting on being released from liability for such nonperformance. However, having a certificate from a chamber of commerce will strengthen the party's position in the event of litigation. We see that currently, in practice, in most cases the chamber of commerce refuses to deem some situations force majeure in the context of the restrictions.*

D. Article 401(3) envisions only **release from liability for nonperformance of an obligation, but not from performance of the obligation itself**. If the adoption of state or local government acts made it impossible to perform all or part of an obligation, the obligation terminates in its entirety or in the respective part on the basis of Articles 416 and 417 of the RF Civil Code.

Dentons' comment: *It needs to be understood what path the court practice will take, for example, with regard to lease agreements, which are ongoing relationships. If a tenant is unable to use the space at any time as a result of measures taken by the state authorities, but the tenant's assets or equipment continue to be located in the space, and the owner continues to maintain the building itself, is this a case of complete or even partial termination of obligations (for example, the tenant's obligations to pay rent)?*

Question: Can the epidemiological situation, restrictions or self-isolation policy be deemed grounds for amendment or termination of a contract? If so, under what conditions?

Amendment or termination of the contract are possible in these circumstances:

(i) On the basis of a material change in circumstances pursuant to Article 451 of the RF Civil Code (**unless the contract explicitly states that this article does not apply** or the context of the contract otherwise implies). The Supreme Court states that **the terms of a contract may be changed in exceptional cases** when it is against the public interest to terminate the contract or will cause the parties much more damage than the costs of performing the contract on the conditions amended by the court. **When granting a claim to amend the terms of a contract, the courts must state which public interests are harmed by termination of the contract or substantiate the parties' major damage from terminating the contract**.

(ii) On the basis of other provisions of law granting a party the right to repudiate the contract or amend its terms and conditions (notwithstanding Article 451 of the RF Civil Code), for example, Article 328 of the RF Civil Code (reciprocal performance of an obligation) or Article 19 of Federal Law No. 98-FZ of April 1, 2020, on Amendments to Certain Legislative Acts of the Russian Federation on Emergency Prevention and Response, which requires landlords to provide tenants with rent deferrals on the terms and conditions set forth by the Russian Federation Government, and tenants' right to request a rent reduction.

The Supreme Court notes that, unless otherwise established by a law or other legal act, the consequences of termination or amendment of a contract in such cases are determined on the basis of Article 451(3) and Article 453(4) of the RF Civil Code. In particular, Article 451(3) of the RF Civil Code provides that, in case of termination of the contract, a court, at the request of one of the parties, shall determine the consequences of termination of the contract based on the need for **just distribution between the parties of the expenses incurred by them in connection with performance of the contract.**

Dentons' comment: *Based on the text of the Review, we can conclude that the Supreme Court did not provide fundamentally new clarifications of how to apply Article 451 of the RF Civil Code. However, **it is important** that the Supreme Court stated (note: this is our interpretation) that the tenant's request for a rent deferral or discount under Article 19 of Federal Law No. 98-FZ is a separate case where the courts may not refuse to amend the terms of the lease agreement on the basis that the request does not comply with the provisions of Article 451 of the RF Civil Code (this position should also apply in a situation where Article 451 of the RF Civil Code is explicitly ruled out by the lease agreement).*

Question: What are the legal consequences when the last day of the time for performance of an obligation falls on a day that was declared a non-working day by the Russian Federation President's Decrees No. 206 of March 25, 2020, and No. 239 of April 2, 2020?

The Supreme Court clarifies that the non-working days that were declared as such by the Russian President's Decrees No. 206 of March 25, 2020, and No. 239 of April 2, 2020, **cannot be considered** non-working days in the meaning of the RF Civil Code. There, they usually mean **days off and non-working holidays defined in Articles 111 and 112 of the Russian Federation Labor Code**. To interpret them otherwise would mean that absolutely all civil obligations would be suspended for a long time and commerce would be severely limited, which is inconsistent with the purposes of the Russian President's Decrees.

The establishment of the **non-working days from March 30 through April 30, 2020, is not a ground to postpone the time for performing an obligation based on the provisions of Article 193 of the RF Civil Code**, unless the person who performed the obligation late is released from liability under Article 401 of the RF Civil Code (i.e., as a result of force majeure).

Contacts

Sergey Trakhtenberg
Partner, Head of Russian Real Estate and Construction practice
T: +7 495 644 05 00
M: + 7 903 201 99 14
E: sergey.trakhtenberg@dentons.com

Olga Elliott
Senior Associate, Real Estate and Construction practice
T: +7 495 644 05 00
E: olga.elliott@dentons.com

Tatiana Petrykina
Senior Associate, Real Estate and Construction practice
T: +7 495 644 05 00
E: tatiana.petrykina@dentons.com

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