

Newsletter

Review of the Russian court practice regarding influence of the anti-Russian sanctions on contractual obligations.

October 25, 2018

Dear Ladies and Gentlemen,

As you know, the first international economic sanctions against the Russian Federation were imposed in 2014, due to the situation in the Crimea. Since then, the EU and the USA have imposed a number of the anti-Russian sanctions, having a significant, consequent impact on the fulfillment of civil obligations in Russia.

In light of the above, and due to the growing pressure of the anti-Russian sanctions, and the increasing number of the entities in respect of which new restrictions are being imposed, we present, for your attention, an overview of the legal positions of the Russian courts on the impact of the sanctions regime on the discharge of contractual obligations.

1 Currently, the Russian courts are facing the need to answer the following questions, regarding the impact of anti-Russian sanctions on the performance of contractual obligations:

- (A) May compliance with the sanctions regime, and/or enforcement by a party of the related contractual provisions, be considered as a violation of the public policy of the Russian Federation, and may such conduct be regarded as bad faith;
- (B) May imposition of sanctions be considered as a force majeure, in accordance with clause 3 of Art. 401 of the Civil Code of the Russian Federation (the "CC RF");
- (C) May imposition of sanctions be considered as a material adverse change of circumstances, under Art. 451 of the CC RF;

(D) Does the role of a party, in a contractual obligation, which became impossible to fulfill due to imposition of the sanctions regime, matter?

2 Developing Russian court practice, regarding the above issues, includes the following legal positions:

2.1 The Constitutional Court of the Russian Federation: compliance with the sanctions regime by a contract party itself indicates its bad faith.

In accordance with the well-known legal position of the Constitutional Court of the Russian Federation, compliance with the anti-Russian sanctions, which violate provisions of international law, by any entity, including a foreign one, can by itself be considered as bad faith conduct and, therefore, be a sole ground for refusal of legal protection¹.

The above-mentioned legal approach has been further developed in the *LLC Siemens (Rus) v. Technopromexport*² case on the invalidation of the contract for the supply of gas turbines, as the contract concluded under the influence of delusion. The plaintiff claimed that the company was not aware that the turbines were actually intended for supply to the Crimea, and that it would have never entered into such a contract with this knowledge. The courts concluded that compliance by the Russian entity with the regime of anti-Russian sanctions violates the public policy of the Russian Federation.

In other words, if a Russian person voluntarily complies with the sanctions regime, established by a foreign state, such conduct might be considered as bad faith conduct and, under certain circumstances, as a violation of the public policy of the Russian Federation.

¹ See Decision of the Constitutional Court of the Russian Federation N 8-P dated February 13, 2018.

² Decision of the Ninth Arbitrazh Appeal Court N 09AP-9815/2018 dated April 10, 2018, case N A40-171207/17. By the Decision of

the Arbitrazh Court of the Moscow Region N F05-8233/2018 dated June 27, 2018 the decision of the Ninth Arbitrazh Appeals Court was upheld.

2.2 The Supreme Court of the Russian Federation: compliance with the sanctions regime by a third party may be considered as a force majeure circumstance, or a material adverse change for a contracting party that engages such a third party (sub-contractor) to perform a contract.

2.2.1 Imposition of the sanctions may be considered as a force majeure (Subsection 3 of the Art. 401 CC RF) in case the performance of contractual obligations becomes impossible for a contracting party, due to compliance with the sanctions regime by the third parties.

For example, in *Ministry of Defense v Zvezdochka*³ case, the courts dismissed the Ministry's claims arising from a state procurement contract, since the defendant's failure to fulfill its obligations was directly caused by the repudiation of respondent's foreign contractors, which refused to supply certain items, due to imposition of the EU sanctions against Russia. At the same time, the courts noted that the causal link between the imposition of the sanctions and the impossibility to discharge an obligation should be direct.

Similarly, in the *Keleanz Medical v VTC*⁴, the courts concluded that, if the imposition of anti-Russian sanctions resulted in impossibility to supply equipment to the Russian dealer (seller under the contract) by its foreign manufacturer, such sanctions may be considered as a force majeure for a contracting party.

2.2.2 Similarly, imposition of the sanctions may be considered as a material adverse change of circumstances (Art. 451 CC RF), if the fulfillment of the contractual obligation became impossible because of the compliance with sanctions regime by third parties.

In *Ministry of Defense v Vector*⁵ case, the courts recognized, as a material adverse change, the imposition of the economic sanctions by the EU and the United States, as the result of which it became impossible to supply the Russian entity with integrated circuits produced in the USA.

2.2.3 At the same time, Russian courts are not inclined to consider the sanctions regime, as the result of which a person is forced to take measures to restructure its business, as a material adverse change.

For example, in *VTB v Bikmaeva*⁶ case, the court pointed out that, if a demand to terminate the contract is caused by imposition of the sanctions entailing significant losses for the entity and consecutive the need to optimize the business, Article 451 of the CC RF shall not apply, since such influence of the sanctions regime is an ordinary business risk.

3 Conclusions

3.1 Thus, the developing judicial practice identifies the difference between situations in which the contractual party itself complies with the sanctions regime, and when the parties are deprived of the opportunity to fulfill the obligation, due to such compliance by the third parties:

(A) Imposition of the sanctions may be considered as a force majeure, or a material adverse change for an entity, which cannot fulfill an obligation, as the result of compliance with the anti-Russian sanctions by third parties (foreign). For this conclusion, there should be a direct causal link between the imposition of the sanctions and impossibility in the fulfillment of the contractual obligations, while an indirect impact of the sanctions regime is not enough.

At the same time, we believe that the possibility of applying clause 3 of the Art. 401 and the Art. 451 of the CC RF to a larger extent depends on the factual circumstances of a particular case, including the nature of the contractual obligation, whether it is possible to replace a supplier, or purchase similar goods from it, the jurisdiction of the parties, and so on.

(B) With reference to the legal position of the Russian Constitutional Court, the Russian entity's own compliance with the sanctions regime may be considered by the Russian courts as a bad faith conduct, violating the public policy of the Russian Federation.

3.2 At the same time the courts still have to answer the question about the possibility for the parties to include, into contracts, conditions allowing enforcement of certain rights under a contract, depending on the occurrence of certain circum-

³ See Decision of the Arbitrazh Court of the Moscow Region N F05-21409/2017 dated February 20, 2018, case N A40-39224 / 2017. By the Ruling of the Supreme Court of the Russian Federation N 305-ES18-7696 dated June 22, 2013, the transfer of case N A40-39224/2017 to the Judicial Board for Economic Disputes of the Supreme Court of the Russian Federation for review of this decision by way of cassation was dismissed.

⁴ See Ruling of the Supreme Court of the Russian Federation N 307-ES18-11373 dated August 20, 2018 case N A56-89542/2016.

⁵ Decision of the Ninth Arbitrazh appeal court N 09АП-25167/2018 dated June 26, 2018, case N A40-221653/17.

⁶ Ruling of the Supreme Court of the Russian Federation N 301-ES16-18586 dated May 23, 2017.

stances of a sanctions nature (for example, granting the right to terminate, suspend or amend the contract). To resolve this issue, the courts will have to assess the limits of contractual freedom in the context of the developing practice.

Another issue, which remains open, is the responsibility of Russian companies' management for compliance, or non-compliance, with the sanctions

regime, taking into account the general provisions of liability under corporate law (for example, the possibility to claim for damages caused by bad faith and unreasonable actions of the management). This becomes even more challenging in the light of previously-announced initiatives to criminalize the compliance with the anti-Russian sanctions.

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If you have any questions, please, do not hesitate to contact Andrey Zharskiy, Anton Dzhuplin or Sergey Petrachkov, ALRUD Partners



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