

client alert

CONTRACT LAW | RUSSIA |

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KEY AMENDMENTS TO RUSSIAN CONTRACT LAW

A major reform of Russian contract law will come into effect on 1 June 2015 (the "**Reform**"). The Reform, which results from Federal Law No. 42-FZ dated 8 March 2015 ("**Law No. 42-FZ**"), will introduce significant amendments to Part 1 of the Civil Code of the Russian Federation (the "**Civil Code**"). Such amendments shall provide more flexibility in contractual matters and make Russian contract law more appealing to the business community.

The amendments will introduce legal instruments whose use is already widespread in other jurisdictions (notably in M&A practice) but have not until the present time been recognised under Russian law. For example, the Reform will introduce the following novelties:

- the mechanism of representations and warranties (new article 431.2 of the Civil Code);
- the instrument of indemnification of losses in case of occurrence of events specified in the agreement (new article 406.1 of the Civil Code);
- the concept of option agreements (new articles 429.2 and 429.3 of the Civil Code);
- the definition of framework agreements (new article 429.1 of the Civil Code).

The Reform will also create new means of securing contractual obligations, including the institutes of security payments and of independent guarantees.

More generally, the Reform will amend numerous provisions of the Civil Code related to general law of obligations. It will, among others:

- strengthen the principle of good faith in contractual matters;
- define general negotiations rules;
- clarify preliminary contracts' regime;
- ensure the recognition of conditions precedent;
- amend the general rules on the calculation of interest rate;
- include certain new features for contractual liability.

The present Client Alert gives an overview of the main provisions of the Reform.

REINFORCEMENT OF THE PRINCIPLE OF GOOD FAITH

The Reform introduces certain amendments to Article 307 of the Civil Code in order to reinforce the principle of good faith in contractual matters.

According to these amendments, the parties shall act in good faith at negotiations, execution and termination of obligations stages. They shall take into consideration their mutual rights and interests, provide each other with the necessary support to achieve the purpose of the obligation and give each other the required information.

PRECONTRACTUAL NEGOTIATION RULES

The Reform defines in article 434.1 of the Civil Code general rules related to pre-contractual negotiations.

Pursuant to these rules, the parties shall conduct negotiations in good faith. In particular, they shall not enter into any negotiations if they do not intend to conclude an agreement or otherwise act in bad faith. A party shall among others not provide the other party with incomplete or inaccurate information, refrain from the disclosure of confidential information and abstain from sudden and unreasonable termination of negotiations.

The party that is deemed to have acted in bad faith shall indemnify the other party for the losses that it has incurred. Said losses cover the expenses related to the conduct of the negotiations and the loss of the possibility to conclude an agreement with a third party.

In addition, the parties may enter into an agreement related to the terms and conditions of their negotiations. This agreement may define their rights and obligations during the negotiations, set forth the allocation of their expenses and fix the sanctions for breach of their obligations at the negotiations stage.

These new provisions shall in practice result in the recognition and enforceability under Russian law of traditional negotiation instruments such as letters of intent, memoranda of understanding, non-disclosure agreements, etc.

CLARIFICATION OF THE PRELIMINARY CONTRACTS' REGIME

The Reform clarifies the rules on preliminary contracts set forth in article 429 of the Civil Code.

It results from these amendments that a preliminary contract shall contain conditions on the subject of the main agreement as well as conditions in relation to which an agreement shall be reached at the request of one of the parties.

This definition of the conditions to be specified in preliminary contracts are aimed at facilitating their conclusion since prior to the Reform, the parties were required to define in their preliminary contract the substantial terms and conditions of the main agreement. In practice, this requirement was rather difficult to implement.

Furthermore, the Reform specifies the deadline within which a party to a preliminary contract may file a claim in Russian courts in order to compel the other party to enter into the main agreement. Said claim may be filed within 6 months from the moment when the obligation to conclude the main agreement had to be executed.

REPRESENTATIONS AND WARRANTIES

It results from the new article 431.2 of the Civil Code that a party may make representations regarding circumstances being of importance for conclusion, execution or termination of an agreement (including in relation to the subject of this agreement, its compliance with applicable law, the powers of the representatives of the parties, the existence of required licenses and permits, the financial situation of the parties, etc.).

If a representation made by a party is inaccurate and this party knew that the other party relied upon this representation or had reasonable grounds to assume so, it shall at the request of the other party compensate the damages caused by said misrepresentation or pay the amount defined in a penalty clause. The party that relied on a material representation which proved to be inaccurate may also unilaterally terminate the agreement.

INDEMNIFICATION OF LOSSES

Pursuant to the new article 406.1 of the Civil Code, the parties can provide for the obligation of a party to compensate the losses incurred by the other party in case of occurrence of certain events defined in the agreement (i.e. losses not related to a breach of the agreement and resulting from impossibility to execute an obligation or third parties or state authorities claims, etc.).

The indemnification amount or the conditions for its determination shall be defined in the agreement. Russian courts are in principle not entitled to reduce the contractual amount of the indemnification except if it is proved that a party has willfully increased the amount of its losses.

This indemnification mechanism could be used in relations between professionals only. However, it may also apply to a physical person when she/he is party to a shareholders' agreement or a share purchase agreement that sets forth an indemnification obligation.

RECOGNITION OF CONDITIONS PRECEDENT

The Reform confirms the recognition under Russian law of conditions precedent and thus allows the parties to make a transaction conditional upon the will of one of the parties. Prior to the Reform, the validity of potestative conditions was generally not recognized by Russian courts.

More specifically, the Reform clarifies in article 327.1 of the Civil Code that the execution, modification or termination of contractual rights and obligations could be linked to any conditions (actions or abstentions of a party, occurrence of a specific event), including those depending on the will of a party.

OPTION AGREEMENTS

The Reform introduces to the Civil Code the institution of option agreements as follows:

- a party can grant to the other party the right to conclude one or several agreement(s) in accordance with the terms and conditions defined in the option agreement (new article 429.2 of the Civil Code). This option mechanism shall in practice ensure the recognition under Russian law of put and call agreements;
- a party can grant to the other party the right to require the execution of certain actions (e.g. pay an amount, transfer or accept assets, etc.) within the deadlines and in accordance with the terms and conditions defined in the option agreement (new article 429.3 of the Civil Code).

FRAMEWORK AGREEMENTS

The Reform provides in article 429.1 of the Civil Code a definition of the concept of framework agreement.

A framework agreement is defined as an agreement determining the general conditions of the contractual relations between the parties, which may be specified in additional agreements or separate specifications.

This definition is a rather important novelty given the widespread use of framework agreements in practice.

INDEPENDENT GUARANTEES AND SECURITY PAYMENTS

The Reform creates new means of securing contractual obligations.

One of these new means is the independent guarantee (articles 368 to 379 of the Civil Code as amended by the Reform). The independent guarantee is a guarantee on first demand that can be issued by any commercial entity and not only by a bank.

In addition, the Reform introduces the institute of security payments. New articles 381.1 and 381.2 of the Civil Code provides that execution of monetary obligations determined in the agreement, including undertakings to compensate damages or pay penalties, existing or future obligations, can be secured by a security deposit (i.e. a sum of money).

NEW RULES ON CALCULATION OF INTEREST RATE

As of 1 June 2015, a new general rule for calculating interests under article 395 of the Civil Code (liability in case of non-performance of a monetary obligation) will be in effect. This rule is applied in case the law or the contract does not provide for a different interest rate. Instead of being calculated on the basis of the Central Bank key interest rate, the interest rate will be calculated on the basis of the average rate of interests on individual bank accounts for the corresponding period. This average rate will be published by the Central Bank of Russia and will vary by region.

AMENDMENTS RELATED TO CONTRACTUAL LIABILITY

The Reform notably amends the following provisions of the Civil Code related to contractual liability:

- The Reform introduces certain amendments to article 393 of the Civil Code in order to clarify the rules for determining the amount of repairable damages. In particular, the amount of repairable damages shall be determined with a reasonable degree of certainty. The court shall not have the right to reject the demand for compensation resulting from non-performance or improper performance based solely on the fact that the amount of damages could not be determined with a reasonable degree of certainty. In this case, the amount of damages shall be determined by the court bearing in mind all the circumstances of the case and the principles of fairness and of the proportionality of liability for the non-performance committed by the debtor.
- The Reform establishes in article 310 paragraph 3 of the Civil Code the right of a party to unilaterally amend or terminate an agreement agreed upon among professionals subject to the payment of compensation to the other party (break-up fee).
- The Reform restricts the cases in which the courts are entitled to reduce a penalty clause stipulated in an agreement agreed upon among professionals. In this respect, article 333 of the Civil Code (in the version amended by the Reform) provides that a reduction by a judge of the amount in the penalty clause is permitted in exceptional cases if it is established that the payment of its amount would result in an unfair advantage for the creditor.
- The Reform extends to any contract the conditions previously applicable only to the early termination of supply agreements due to their non-performance or improper performance (new article 393.1 of the Civil Code).

CONTACTS

DAVID LASFARGUE
lasfargue@gide.com

BORIS ARKHIPOV
arkhipov@gide.com

TIM THEROUX
tim.theroux@gide.com

EKATERINA VILENSKAYA
vilenskaya@gide.com

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