



Contractual disruptions and Russia

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The new EU sanctions against Russia pose challenges for companies with trade relations with Russian companies in many areas. Legal bans, rising prices and supply bottlenecks make the execution of contracts considerably more difficult, but do not per se release companies from their contractual obligations. The sanctions not only affect contracts with Russian trading partners but may also have an indirect impact on contracts with other trading partners, for example if Russian suppliers are involved.

This article provides information based on German law. The same general principles apply to other jurisdictions; however, appropriate legal advice remains indispensable.

Obligation to fulfill the contract?

If a contract regulates the delivery of goods or the provision of (financial) services that are directly or indirectly affected by the sanctions, contractual rights and obligations generally remain in place.

However, some sanctions regulations also provide for exceptions for certain purposes, pre-existing contract clauses for contracts concluded before February 26, 2022, and settlement periods. In this way, even though the service owed is actually affected by the

sanctions regulations, the contractual partners do not encounter any difficulties in fulfilling the contract. Framework supply agreements that already exist and still have a longer contractual term could also fall under the pre-existing contract clauses.

It should also be noted that the sanctions do not, so far, prohibit the transit of goods through Russia. An obligation to supply sanctioned goods to a creditor in another state is therefore still possible even if they must be sent through the Russian territory.

Exemption from the obligation?

Whether a contracting party has legal possibilities to exempt itself from individual obligations, to adapt contracts or even to withdraw from them, depends on the individual case and is linked to narrow preconditions. In principle, inefficiency due to sharp price increases alone is not sufficient. Delivery failures must also be taken into account as part of the assumed procurement risk. If necessary, the contractual partner must change the supplier.

The possibility of release from a contractual obligation depends on whether (1) a provision for an exception from the contractual obligations has been agreed in the contract itself and (2) which choice of law has been



made for the contract, i.e., whether German, foreign or UN sales law applies.

Contractual clauses

In commercial and supply contracts, there are mostly clauses called “force majeure” or “hardship clauses”.

Force majeure

“Force majeure” clauses regulate unforeseeable, unpreventable events that are beyond the control of the contracting parties. The clauses explicitly list the events that are to be recognized as force majeure at the factual level. These usually include natural disasters, terrorist attacks, labour disputes, pandemics, government seizures and expropriations - as well as embargoes and wars. However, the events mentioned are not usually listed exhaustively. In individual cases, therefore, it must be examined whether an event not listed is comparable in its scope and consequences to the other events. The contractual partner must also be able to demonstrate that this event is unforeseeable and uncontrollable and that it is the actual cause of the impairment of the contractual performance.

As a legal consequence, the contractual partner is released from the obligation to perform as long as the said event continues and he cannot legally or actually fulfil his contractual obligation precisely because of this event. Neither a fault nor a delay in performance can be attributed to him – thus, he is not obliged to pay damages.

Problems can arise if Russian contract law is to be applied and embargoes or sanctions are not listed in the force majeure clause, as Russian courts often do not classify sanctions as force majeure.

Hardship

The hardship clauses become relevant when, in case of force majeure, it is still legally and factually possible for the contractual partner to fulfil the obligation to perform but only with considerable practical and financial expenditure which makes the fulfilment unreasonably difficult over a longer period of time.

Hardship clauses grant the contracting parties the right to adjust the contract (in terms of time or price) or even to terminate it. However, hardship clauses are less common than force majeure clauses.

Legal provisions

Statutory provisions can also be relevant for a release from the contractual obligations or from the contract itself. First, it must be considered which legal system is applicable. If two German companies are the contracting parties, German law is usually applicable. However, if one of the contracting parties is not domiciled in Germany, the parties often make their own choice of law. In the absence of such a choice, according to the Rome I Regulation of the EU, the national law applies to sales contracts in which the contracting party owing the performance typical for the contract has its registered office.

German law

Under German law, there are several provisions that may allow for a release from the obligation to perform, for an adjustment of the contract or for a release from the contract.

Impossibility of performance

If, for example, sanctions explicitly and strictly prohibit the export of certain goods from Germany to Russia, a German debtor’s performance is legally impossible. A violation of the EU sanctions is punishable under § 18 of the Foreign Trade and Payments Act if it is committed intentionally, and under § 19 of the Foreign Trade and Payments Act it is an administrative offense if it is committed negligently. German law provides for subjective and objective impossibility. This is a case of so-called subjective impossibility (§ 275 (1) BGB). Subjective impossibility occurs when the performance is impossible for one particular debtor. As a result, if the debtor notifies his contractual partner (= creditor) of this impossibility, he is released from the obligation to perform. The creditor may in turn withdraw from the contract.



Another case of subjective impossibility occurs when the debtor is hindered to perform by practical and for him personally insurmountable obstacles. For example, the debtor could invoke it if it is not possible for him to move goods from one place to another due to blockades of transport routes caused by war, or if goods have been confiscated. Here, too, the debtor is not responsible for the impediment to performance and not liable for damages.

In addition to subjective impossibility, § 275 (1) BGB also includes objective impossibility. This occurs if the promised performance is impossible for everyone. A conceivable case of application could be the owed delivery of custom-made products or the provision of services to a Russian company, which no one else can produce or perform in the owed manner because, for example, the supplier's individual know-how is required. If this good or service may no longer be exported to Russia, the debtor can invoke the objective impossibility of the performance to be released from the obligation.

Interference with the basis of the contract

When the contract is concluded, the performances owed to each other are typically in a relationship of equivalence. An interference with the basis of the contract occurs when this equivalence relationship is massively shifted, so that the exchanged services no longer have a value in relation to each other and an extreme loss-making transaction is threatening.

In Germany, the interference with the basis of the contract is regulated by § 313 BGB. The provision requires that (1) essential circumstances on which the contract was based have changed seriously and (2) the parties would not have concluded the contract or would not have concluded it in the same way if they had known about these new circumstances and that (3) the party burdened by this can no longer be expected to adhere to the contract after weighing the interests of both parties. As a legal consequence, the affected contracting party can demand an adjustment of the contract or withdraw from it, whereby the adjustment has priority as a milder means.

In practical terms, sanctions can induce an extreme rise in the costs for production and procurement of goods or services. As a result, these can be far higher than the agreed price or remuneration.

A massive shift in the equivalence ratio can also occur if payment obligations are to be made in another currency and the exchange rates of one's own currency and the foreign currency unexpectedly and unforeseeably differ greatly. Currently, this danger exists in particular if payments are to be made in Russian roubles instead of EUR or USD. According to German law, an interference with the basis of the contract should then be assumed. In this case, the payment creditor would also have a right to adjust or withdraw from the contract.

Russian law also recognizes the right to adjust the contract due to an interference with the basis of the contract, but changes in exchange rates/foreign exchange rates are usually not recognized as such.

UN Sales Convention

The UN Convention on Contracts for the International Sale of Goods also recognizes the exemption from the obligation to perform due to force majeure. Art. 79 CISG regulates the conditions for a release from the obligation to perform, based on a "cause of impediment beyond the control of the debtor" which could not be expected at the time of the conclusion of the contract.

Cancellation of the contract

If both parties agree that it is no longer reasonable and feasible for them to maintain the contractual relationship in the future without major problems, they can also jointly decide to terminate the contract; the basic principle of private autonomy applies.



Future contracts

When concluding future contracts, care must be taken that the promised performance does not fall within the catalogue of sanctions. Otherwise, the contracts may be invalid or void due to the violation of a statutory prohibition (§ 134 BGB).

It should also be noted that the debtor of a performance may be liable for damages to his contractual partner if he knew or should have known of an impediment to performance due to the sanctions already at the time of conclusion of the contract (§ 311a BGB).

If delivery difficulties are foreseeable or could increase due to the sanctions, new contracts should include clauses that grant a right to adjustment (e.g., price increase or refusal of performance) or a right of withdrawal or termination. In the case of foreseeable payment uncertainty, the parties could also agree on a retention of title until the price has been paid.

Investment protection and payment guarantees

Entrepreneurs should also note that Russia is taking or has taken countermeasures against the western sanctions that endanger foreign investors in Russia. For example, companies from countries that have imposed sanctions against Russia with more than 100 employees and a balance sheet total of at least 1 billion roubles may in future be placed under the supervision of the Russian state. Further measures by the Russian government are not ruled out.

In addition, Russian companies are economically unstable. Payment defaults are to be feared. So far, it has been possible to make use of export credit guarantees as well as investment guarantees. These can no longer be relied on. The guarantees of the Federal Republic of Germany for export business to Russia, for example, have now been stopped until further notice. The consequences will also affect small and medium-sized enterprises to a considerable extent.

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