

*In pursuance of the Civil Law Development Concept, on March 8, 2015 President of the Russian Federation signed the Federal Law on Amendments to Part One of the Civil Code of the Russian Federation, No. 42-FZ, which was adopted by the State Duma on February 25, 2015 and approved by the Federation Council on March 4, 2015 (“Law”). The amendments to the Civil Code (“CC”), which mostly relate to law of obligations, **will take effect as of June 1, 2015.***

Key Amendments to CC

The key changes and additions include *inter alia*:

- conditional performance of obligations (potestative conditions);
- reimbursement of losses arising upon occurrence of events stipulated in a contract;
- representations;
- an option and an option agreement;
- a newly introduced duty to act bona fide when creating and performing an obligation and after its termination with due regard for the purpose of such obligation, rights and legal interests of the parties to the obligation;
- possibility to define the term for performance of a party’s obligation by reference to the moment when the other party’s obligations are performed or to the occurrence of another event;
- “alternative obligation” now defined more accurately and a definition of “optional obligation” is introduced;
- creditors agreement on the procedure for satisfaction of their claims against debtor;
- adjustments of rules for ranking of claims arising from homogeneous obligations;
- introduction of a general rule on the ability for a creditor to claim specific performance of an obligation and, if the relevant court’s order has not be fulfilled, to claim a penalty in addition to damages suffered;
- detailing of rules concerning unilateral refusal from performance of an obligation and unilateral change of the terms thereof, in particular under contracts;
- statutory interest;
- independent guarantee (now the regime of bank guarantee is available for guarantees issued by other commercial organizations);
- security deposit;
- legislative framework for some legal approaches developed earlier by the RF Supreme Arbitrazh Court, that purports to increase surety’s liability and to balance interests of creditors and sureties;
- possibility to use an earnest payment as security for the obligation to enter into a principal contract on the terms provided in a relevant preliminary contract;
- reimbursement of damages using the substitute transaction principle (i.e. based on the price of a similar contract or the current price), which was earlier applied for delivery contracts, now is generally applicable to termination of contracts;
- introduction of “reasonable reliability” principle to be applied by courts when determining the amount of reimbursable damages;

- late payment interest under Article 395 now determined based on an average bank interest rate for private deposits at creditor's location;
- court's right to reduce a contractual penalty payable by a person engaged in business activities is now limited to exceptional cases where it is proved that payment of the penalty amount agreed in the contract would result in creditor's gaining unjust benefit;
- framework agreement and subscriber's agreement;
- broader scope of applicability of the rules concerning adhesion contracts;
- newly introduced provisions on pre-contractual negotiations;
- limitation of non-performing party's ability to challenge a contract.

Below we describe in more detail some of the amendments to CC, most eagerly awaited by business community, that purport to create necessary legal environment for structuring investment and M&A transactions and corporate agreements within the Russian legal framework and to enable businesses, where need be, to avoid application of foreign law with respect to projects and transactions closely connected with the territory of Russia and/or involving Russian assets.

Negotiating Process and Liability for Unfair Negotiating

The new Article 434.1 of CC regulates issues that may arise between parties in connection with their negotiating an agreement. The Article expressly sets the parties' duty to act bona fide when they enter into and conduct negotiations and upon completion thereof. In particular, CC discourages a party who has no real intention to reach an agreement from entering into or continuing negotiations. A negotiating party who has conducted or disrupted negotiations acting in bad faith is required to reimburse the other party for damages caused by such conduct or disruption. These damages may include the other party's costs incurred in connection with the negotiations and loss of an opportunity to contract with a third party.

Negotiating parties may sign an agreement determining the negotiating terms and set forth therein specific requirements concerning the bona fide negotiation duty, provisions on distribution of negotiation costs and other relevant rights and obligations. Such agreement may provide for a penalty for breach of its provisions.

The above-mentioned rules apply irrespective of whether or not negotiations result in parties' making a contract.

Conditional Performance of Obligations

The new Article 327.1 of CC authorizes so-called 'potestative conditions' in the Russian law. Now the law provides that the performance of obligations as well as the exercise, change or termination of certain rights arising from a contractual obligation can be made conditional upon *performance or non-performance* by one of the parties of certain actions or upon occurrence of other *events contractually stipulated, including those being within sole control of one of the parties*. Thus, the law expressly permits making the performance of contractual obligations conditional upon occurrence of events that are within the sole control of one of the parties, and such permission should entail revision of the existing case-law which has predominantly relied upon the principle that potestative conditions are inadmissible.

From the practical point of view, this Article allows parties to make complicated, multi-phase transactions under which parties often assume a great number of interrelated obligations, including conditions precedent, the fulfillment of which is not infrequently extended over some period of time and depends on numerous factors, such as bona fide performing by the parties of their obligations or certain actions and/or refraining from such actions in the course of making or before closing a transaction.

Representations

The new Article 431.2 of CC introduces the concept of representations relating to circumstances that are relevant for the purpose of entry into, performance or termination of an agreement and establishes the obligation of a party making such representations to reimburse the other party for its damages caused by inaccuracy of the representations or to pay it a contractual penalty.

CC does not contain an accurate definition of “*representations*”. Instead, it provides a non-exhaustive list of matters with respect to which representations can be made, such as subject of an agreement, authority to enter into it, compliance of the agreement with applicable law, availability of licenses and permits, financial standing of a party, a third party.

If representations that are essential to a party who has relied upon them are proved to be inaccurate, such party, besides being able to claim damages or a penalty, is entitled to terminate the agreement. Parties may provide otherwise in their agreement.

Generally, a party who made inaccurate representations will be held liable if it assumed or should have reasonably assumed that the other party would rely upon such representations. It is recognized that the party who made such representations was aware that the other party would rely thereon if inaccurate representations were made:

- (a) in the course of business activities;
- (b) in connection with a corporate agreement; or
- (B) a share transfer agreement.

In such cases, unless otherwise expressly provided by the parties’ agreement, the party who made inaccurate representations will be liable regardless of whether or not it was aware of inaccuracy of such representations.

If a contract has been found void or invalid, this fact alone does not preclude imposition of liability on the party who made inaccurate representations.

Options

Option to Enter into a Contract

The new Article 429.2 of CC allows an *agreement on grant of an option to enter into a contract*, under which a party making an irrevocable offer to the other party grants it the right to enter into a contract or contracts on such terms and conditions as provided for by the option. The exercise of the option, i.e. of the right to enter into a contract by acceptance of the offer granted, may also be made conditional upon occurrence of an event stipulated by the option, which may be within control of one of the parties. Generally, an option is granted for money or other consideration, although the parties to an option may deviate from this rule by their agreement.

Option Agreement

An *option to enter into a contract* is distinguished from an *option agreement* authorized by Article 429.3 of CC. Under an option agreement, a party thereto has the right to claim that the other party performs certain actions stipulated in the agreement (e.g., pay money or transfer or accept property). An option agreement may also provide that the claim arising therefrom shall be deemed to have been made upon occurrence of certain events defined in the agreement. Generally, payment of consideration contractually agreed for the right to make such claim is required, except where:

- (a) an option agreement, whether made between commercial organizations or otherwise, is made on a gratuitous basis in accordance with its terms; or
- (b) entry into an option agreement is caused by other obligation or other legally protected interest arising from the parties’ relationship.

Various types of an option agreement may be regulated more specifically by or in accordance with law.

Reimbursement of Losses Arising upon Occurrence of Events Stipulated in a Contract

The amended CC purports to incorporate a kind of an equivalent of “*indemnities*” – a concept known to many developed legal systems, especially Anglo-Saxon law - into the Russian legal framework. Now, parties to an obligation, while pursuing their business activities, may agree in a contract that either party shall reimburse the other party for its pecuniary losses arising upon occurrence of events defined in the contract, that have not been caused by a breach of a party’s obligation, (such as losses caused by impossibility to perform an obligation or a third party’s claim or a government authority’s order against a party or a third party designated in the contract). The same possibility is afforded to parties to a corporate agreement or a share transfer agreement, one of which is an individual.

The parties may agree on an amount of reimbursable losses or a method of determination thereof. A court may not reduce an amount of reimbursable losses so agreed, unless it is proved that a party willfully contributed to an increase of losses.



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