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PERFORMANCE OF OBLIGATIONS AND COMPENSATION FOR LOSSES IN THE RUSSIAN CIVIL CODE

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When an economic actor recourses to compensation for losses as a legal remedy, the main question that arises is what law governs the claim raised by such actor. At a glance, the answer is simple: both Chapter 25 (Liability for Violation of Obligations) and Chapter 15 (Compensation for Losses) of the Civil Code of the Russian Federation contain provisions governing the terms of satisfaction of financial claims. However, such claims not always arise from a failure to perform obligations and sometimes are even raised in the absence of an offence per se. Therefore, quite often we need to consider the extent to which it would be lawful or, perhaps, even appropriate to invoke some of the provisions contained in Subsection 1 "General Provisions of Obligation" of Section III of the Civil Code when dealing with any claims for losses – as opposed to those for obligations.

In our legal discourse, we have to deal with the application of the fundamental concepts of duty and obligation as synonyms. Some official legal publications may be found to use the words "tax obligation".

The regulatory differentiation between obligation and duty is implemented in Article 420 of the Civil Code. It begins by saying that an agreement constitutes an understanding of duties, and its Clause 3 provides that the obligations arising out of an agreement shall be subject to general provisions in addition to special articles. The semantic interpretation is as follows: an agreement also governs duties that neither represent obligations nor consist in "specific actions", and it is really so.

Article 8 (*Grounds for Arising of Civil Rights and Obligations*) of the Civil Code sets out, *inter alia*, the following reasons: events, judicial acts, creation of intellectual properties or property acquisition. However, the Civil Code establishes a legal framework for distinguishing between the two aforementioned terms. Its Article 307 says:

> *"1. By virtue of an obligation, one person (the debtor) shall be obliged to take a certain action in favour of another person (the creditor) such as transfer a property, perform a job, provide a service, contribute to a joint activity, pay an amount of money, etc. or abstain from taking a certain action, and the creditor shall have the right to claim that the debtor should perform his duty.*
>
> *2. Obligations may arise out of agreements or other transactions, from the infliction of damage, as a result of unjustified enrichment or for any of the other reasons set out in this Code.*
>
> *3. In the course of the establishment or performance and after the termination of an obligation, the parties shall act in good faith while taking into account the rights and legitimate interests of each other and mutually assisting each other as may be necessary to reach the intended purpose of such obligation and providing each other with any necessary information."*

Therefore, the grounds for arising of obligations may only be set out in the Civil Code and nowhere else. If interpreted teleologically, Article 307(3) essentially provides that the main characteristic of an obligation is the proposed uniform understanding by the parties to such obligation of the essence, scope, size, terms and purpose thereof, giving an idea how the parties should co-operate in reaching that purpose. Keeping those parameters in mind, the parties to an obligation tend to differ in perceiving claims for losses. The debtor will always tend to either deny the amount claimed or agree on a smaller amount. Under the applicable law, such claims may consist in any future expenses or earnings of the offending party or the cost of any arrangements it is expected to make and may be either increased or decreased.

The concept of obligation, which had originally arisen as a legal instrument and material legal remedy and was subsequently strengthened by institutional methods of securing performance such as pledge, penalty, suretyship, lien, guarantee or security payment, has now become an important commercial value itself and the main transferrable item, taking the form of rights to claim performance of obligations. Anyway, it is a material benefit that saw the volume of transactions therewith growing by hundreds of times during the recent years. At the dawn of

the human civilisation, people disposed of material objects to exchange them. An obligation may be subject to any additional conditions: subsequent, precedent, etc. (Article 157 of the Civil Code).

Loss is expressed as the value of a subjective right that is infringed by any act which may be unlawful or lawful. Articles 307 and 1064 of the Civil Code say that the infliction of a damage or tort shall give rise to an obligation to repair such damage or tort by replacing or restoring the damaged property or eliminating the defect. When a property-related subjective right is infringed, neither the creditor nor the debtor may be said to be obtaining any value. The relationships arising in that case essentially constitute the restoration of the property condition when the only existing duty is not to aggravate losses and the compensation may not be waived but only decreased by contract (Article 15 of the Civil Code).

Compensation for losses plays the role of an alternative legal remedy (Article 1082 of the Civil Code). According to *Principles of European Tort Law* (2002), infliction of damage immediately gives rise to liability in the form of a duty to pay the sufferer a monetary compensation in order to restore, to the maximum extent possible, the sufferer's initial condition with money. However, instead of such monetary compensation, the sufferer may claim recovery in kind, provided that such recovery is possible and is not too burdensome for the other party.

The differentiation between obligations and losses appeared to be inevitable and pre-determined by the regulatory logic, given the need to prove the extent of the right to claim. Efforts to determine the value of an obligation are rarely prone to a disagreement. The "specific action", which constitutes the essence of an obligation under Article 307 of the Civil Code, suggests a uniform understanding of its ideal characteristics. It is the potential difference and complaint about undue performance that cause a dispute over losses as well as other claims that are almost always controversial. Their existence, nature, structure and essence are to be proven. Economically, that could not but result in the relevant rights being treated differently. Some of them should be left free floating and strengthened by the safeguarding mechanisms of consideration, security and facilitated transfer expressed in the concepts of future claims, absence of additional transfer formalities, etc.

The Civil Code clarifies that the purpose of performance of obligations shall be understood uniformly (Article 307(3) of the Civil Code), assuming mainly that its amount is understandable and it is static, determinable, very reliable in terms of discharge of such

obligations and co-operation of the parties and would sometimes be hard to implement if no such co-operation is provided.

No other claims for losses may be identical if only because they result from the lopsided approach to their cost, lawfulness and legality and the appropriate measures to be taken to decrease them. No security method is applicable here without limitation, as such unlimited application would otherwise raise a question about their legal existence because of the accessory nature immanent in them (Article 329(4) of the Civil Code). That said, where a failure to perform an obligation unilaterally translates into a duty to compensate for losses, security instruments are indispensable. It would be advisable to amend Chapter 23 of the Civil Code so as to prescribe that binding support and security mechanisms should be applied to claims for losses, but not to all of them and only to the extent they are compatible with each other.

Compensation for losses under special circumstances as well as other promises to assist, inform or use a particular e-mail address in correspondence all constitute auxiliary duties having no material essence. They do not constitute an obligation. While disregarding them may consist in guilt or lack of care in general, they may not be enforced at law.

The Russian courts have not yet managed to come to a uniform conclusion that a claim for losses is not binding, and Article 328 of the Civil Code may not apply to those relationships. However, as we know, some of Russia's leading legal scholars are quite confident that a breach of an agreement will give rise to an obligation subject to the legal treatment prescribed by Section III of the Civil Code. Notionally, it may well be so as claims to perform obligations are known to be capable of passing, by way of subrogation, to insurers, etc.

It were the obligations to "compensate for any harm or damage" that Russian famous jurists such as Vasily Ivanovich Sinaisky, Iosif Alexeyevich Pokrovsky and Konstantin Petrovich Pobedonostsev wrote about in the 19th century. Mikhail Mikhailovich Agarkov, a well-known Soviet civilist, said that a claim for loss was legally binding.

We believe it was true under the laws that existed in the Soviet era. However, at the present time, especially after 8 March 2015, the regulation of obligations has been considerably detailed and not all rules of law may apply to a claim for loss.

Let us consider the applicability of Chapter 22 of the Civil Code to claims for losses. The new Article 310 of the Civil Code permits a refusal by a commercial entity to perform its

obligations to be stipulated in advance. If Article 310 of the Civil Code covered losses, that would mean a waiver of rights and make it legally possible to pre-agree on avoidance of liability even for gross negligence (Article 401(4) of the Civil Code prohibits any release from liability for malicious intent) – a development that would undermine the concept of loss and result in its losing its importance.

Article 311 of the Civil Code says that the creditor may refrain from accepting partial performance of an obligation, i.e. any disagreement on the total amount of losses would constitute a reason not to accept performance, thereby further aggravating the delay. "The creditor may refrain from accepting partial performance of an obligation, unless otherwise prescribed by law, other legal acts or the terms of such obligation or follows from the customs or essence of such obligation", and such partial performance may be rejected in full.

If claims for losses constitute an obligation, such obligation is financial. It is also worth noting that Article 313 of the Civil Code provides that discharge of a monetary obligation by a third party would mean subrogation and could cause chaos in the domain of loss cases as it would legitimise the involvement of a third party who has paid the losses in full and begins claiming the same from the debtor. Unlike contractual assignment, which is conditioned on a considerable discount off the par value of the claim, while the size and configuration of the claim remain unchanged, its typically disputable nature would make that transaction economically unfeasible and easily induce abuses and arbitrary behaviour of the powerful party.

The debtor may perform an obligation before it becomes mature, unless otherwise prescribed by law, other legal acts or the terms of such obligation or follows from its essence. However, early performance of an obligation related to the business carried out by the parties to such obligation is only allowed where such early performance is expressly permitted by law, other legal acts or the terms of such obligation or follows from the customs or essence of such obligation (Article 315 of the Civil Code). Therefore, the creditor may reject a claim for losses if it is based on the aforementioned Article without any reminder of performance.

Except when a procedural claim precedes an action brought before a commercial court, no notice of payment of any incurred losses should be ever given, resulting in no applicable period of limitation beginning to elapse, which means that the claim becomes eternal – an outcome hardly envisaged by the legislators (Article 314(2) of the Civil Code). Therefore, this performance rule is inapplicable to any award of losses.

However, the inapplicability of binding regulations to the circumstances of losses appears most clearly from Article 328 of the Civil Code, which provides as follows:

> *"... where there are any circumstances clearly showing that... performance will not take place within the agreed time, the party required to provide consideration may... refuse to perform such obligation and claim for losses."*

Let us assume that an agreement contains a provision saying that performance thereunder should be in consideration for a mitigation of any losses. In such arrangement, any unilateral judgment or claim for damage could undermine the principle of *pacta sunt servanda*, which is fundamental for a continental-type legal system.

In the Russian market for legal services, the legal actions brought against certain major manufacturers of expensive or luxury cars stand in the spotlight. After several accidents allegedly resulting from some defects in some of those cars, their wealthy and inventive owners instructed their "inquisitive" lawyers to claim against the manufacturers to refund them for the purchase prices paid for those cars, and after they got their money back they refused to return the cars to the manufacturers on the pretext that they should retain them in consideration for the "losses" allegedly incurred by them as "consumers".

How could Chapter 23 of the Civil Code (*Methods of Securing Obligations*) be relied on in a loss case? As we can see, it is most likely (and we say "most likely" because there are neither any final explanations provided by the supreme judicial authority nor any amendments made to the Civil Code so far) that it would be very difficult to apply it, either. The main methods are penalty, pledge, lien, suretyship, deposit, guarantee and security payment.

Is pledge applicable to claims for losses? Obviously not, because the size of the secured obligation is a material term of the agreement in this case (Article 339 of the Civil Code). The extent of losses is floating and dynamic, it may not be agreed on by the parties and is evaluative by its nature.

Deposit and security payments are also difficult to link with claims for losses for the same reasons. Therefore, despite all efforts made to reform the binding law, the liabilities (mainly for compensation for losses) and obligations are still to be clarified. It would be senseless and unreasonable to identify them in today's realities of more complex property transactions.

The most important method of securing an obligation is penalty, i.e. an amount of money payable for a failure to perform or duly perform such obligation. Penalty is commensurate

with losses. If they constitute the value of an obligation, the penalty payable for a failure to pay them may, at a glance, be also envisaged in an agreement. It would be sufficient to specify that the failing party should pay a penalty for a failure to compensate for any losses incurred during a certain period of time so as to ensure that such claim supports this universal legal remedy – in accordance with the parties' will as construed literally.

We are confident that a claim in respect of the aforementioned transfer of money would be illegal as the burden of losses has a different nature than obligations. A failure to perform obligations would allow invoking the substituting instrument of compensation for losses in an amount depending, first of all, on how such failure takes place. When an agreement is terminated or rescinded for a material breach, the resulting losses are the value of the violated obligation plus any things not received in tort and/or any future costs. But the most important thing is the cash equivalent of the obligation terminated by the interruption of contractual relations. If an obligation is not reasonably converted into losses, such losses will usually be of a much smaller amount.

The concept of penalty is commensurate with losses rather than with the size or value of a failure to meet a claim for any loss, such as, for example, lost profit. Just as there can exist no title to a "right" rather than to a thing, there may be no legal substitute for losses resulting from a failure to pay therefor. A court hearing any claims based on a wrong legal logic would only bring chaos to the understanding of the purpose of losses, which are subject to judicial control and may not be based on any "exaggerated" unilateral estimates.

Lien as a legal remedy is equally incompatible with claims for losses. According to the second paragraph of Article 359(1) of the Civil Code, business people may enjoy a right of lien in respect of any property to be transferred as security for any claims arising from any obligations even if those obligations have no relation to the possession of such property. If such obligations also embrace the legal category of losses, that would create a room for arbitrary behaviour with any superficial perception of current losses constituting a ground for withholding material properties, including cash, bills of exchange, water, gas and other assets, not just classical ones that are characterised by weight, shape and extension in space. Of course, while it is for the courts to finally decide if any unilateral estimates are fair, they should meet specific time constraints. Even more important is the uniform understanding by economic actors of the ties among the key matters of regulation, including, but not limited to, the idea that by no means would a unilateral declaration of losses automatically make its authors creditors for an obligation, nor would it permit them to use the whole arsenal of

security measures in respect of any obligations, otherwise such rarely used legal remedy would translate into an instrument of abuse and manipulation, thereby turning from a hat into a rabbit.

In the Russian Federation, the process of gradual liberalisation of contractual relationships and careful introduction of certain opportunities to withdraw from an agreement is likely to go wrong way.

Let us consider the novation of parties to legal relationships by way of assignment, under contract and law, of a claim in the form of subrogation or transfer of debt. The underlying obligation will then be secured by a suretyship. While the creditor may terminate the agreement and claim for losses, Article 363 of the Civil Code provides that "the surety shall be liable to the creditor to the same extent as the debtor, including payment of any accrued interest, any legal costs incurred to recover the debt and any other losses suffered by the creditor". However, the word "and" appears to constitute an unnecessary clarification here and should be replaced with "or". That is especially true, given the fact that Article 363 is titled *Liability of the Surety*, even though the surety is bound by the agreement, acts for the debtor in performing his obligations and receives the same subrogation claims for those and other losses.

It is a duty rather than an obligation to avoid the effects of Article 404 (*Guilt of the Creditor*) when the amount of any awarded losses decreases depending on the manifestation and extent of such guilt. A claim to refrain from taking a guilty act under Article 393.6 is inconceivable as it pertains to the domain of obligations. A failure to refrain from taking a certain act is a failure to perform an obligation rather than a duty. Such required passivity should entail no classical liability for a failure to perform obligations. No claims to prevent and prohibit a guilty act may have any legal grounds. However, the satisfactory technical approach implemented in some Articles of the Civil Code, such as Article 322 which deals with joint and several obligations, has a limited extent. As Article 322 covers duties (liability) in the event that there are several debtors or creditors for an obligation, we should take into consideration that this provision implies claims for losses.

On the other hand, Article 322 of the Civil Code deals with claims for an obligation, including those related to business, and says that such claims may arise from the terms of such obligation. Article 322 primarily governs matters of compensation for those losses incurred as a result of a failure to perform an obligation, even if there are several beneficiaries. While it is

titled *Joint and Several Obligations*, it also covers multiple creditors. Apparently, its title is not only inaccurate but totally wrong and needs to be replaced with the following: *Joint and Several Liability and Rights to Claim Such Liability for a Failure to Perform Obligations*, while Article 322 itself should be moved to Chapter 25 of the Civil Code.

Often, when someone's trademarks are used and similar means of individualisation are applied in business, no obligations arise to take specific actions. While some people may argue that would mean a tort, i.e. a damage caused to a property, the Civil Code does not apply that term to intellectual properties any longer. It is no longer a property, so it may not be subject to Chapter 59 of the Civil Code anymore. In that case, compensation for losses is prescribed as the main remedy, because recovery in kind is impossible due to the fact that offending acts have been taken and, e.g., resulted in enrichment of the offender.

Article 416 of the Civil Code (*Termination of an Obligation as Non-Performable*) is inapplicable, nor may money be paid as a universal equivalent as it can always be accumulated through a loan, property sale, etc. and transferred in compensation for any losses incurred by the counterparty or creditor.

The death of a debtor will not terminate the claim for losses against him, and that claim will come down to his successors. A property being transferred by way of succession entails duties but not obligations arising not only from the relevant transaction, damage or unjustified enrichment but also for some other reasons, including the incurrence of losses. The successors will bear that burden in proportion to their shares in succession. When trying to determine the correlation between "duty" and "obligation", we see the effect of a natural differentiation of law as property transactions become more and more complex when there is a need to establish a regulatory framework for details, new massive manifestations and significant aspects of important legal categories.

We also consider Article 414(2) of the Civil Code to be obsolete. Novation and replacement of one obligation with another one extend to the so-called "additional obligations". That term is unclear because if there were no such "additional obligations", novation would all the same result in any previous obligation being cancelled. As mentioned above, that term is sometimes used in the legal doctrine to describe the duty to incur somebody else's losses. Certainly, the resulting agreement may re-structure any debt whatever.

Novation is not a free transaction as it gives rise to new claims as well as new obligations and, therefore, results in no donation, which is prohibited between commercial entities (Article

572(3) of the Civil Code). Its correlation with Article 407, which says that an agreement may provide for an obligation to be discharged by the sole will of the debtor, actually emphasises that the same cannot be done with a claim for losses between business entities under Article 572 of the Civil Code or any other entities pursuant to Article 15 of the Civil Code. If the burden of somebody else's losses could constitute an obligation, that would be permitted by the special Article 407 of the Civil Code.

CONCLUSION

The issues discussed in this paper are interesting and topical and deserve a careful elaboration and discussion. Any further improvements of the regulatory framework for recovery of losses must specify in more detail which particular concepts of binding law should apply to claims for losses. The provisions contained in Section III of the Civil Code may be applied by reference, which should be expressly stated in the Civil Code in a way similar to the wording contained in Article 307.1(3), which says that the general provisions concerning obligations should apply to the corporate legal relationships and the effects of invalidation of a transaction.