Client Update

Avoiding Liability for Ceasing Negotiations – Recommendations Following the Auchan Case

In late November 2017, the Commercial (*Arbitrazh*) Court of the Moscow District upheld the decisions of the lower courts to award lost profits in the amount of USD 267,000 in favour of a potential lessor (Decort) against a potential lessee (Auchan) due to unfair conduct during negotiations for a warehouse lease agreement (Case No. A41-90214/2016). The courts found that Auchan had acted unfairly by ceasing negotiations abruptly and unreasonably during the exchange of the execution versions of the lease agreement.

The claim of Decort was premised on Article 434.1 of the Russian Civil Code effective as of June 1, 2015, which provides for a general duty of the parties to negotiate in good faith. A party is assumed to act unfairly if, among other things, it breaks off negotiations abruptly and unreasonably when the other party could not have reasonably expected it.

Because Article 434.1 of the Russian Civil Code only came into effect two and a half years ago, the courts have not yet established clear standards to determine the circumstances where ceasing negotiations may be deemed to be sufficiently abrupt and unreasonable that the conduct of the party will be found to be unfair. Prior court judgments where breaking off contract negotiations was found unfair primarily related to a customer's refusal to enter into a contract with the winning bidder following a tender. Given that the established tender procedures had been followed, the courts usually found that the customer's unreasonable (abrupt) refusal to contract with the winning bidder was an unfair cessation of negotiations.

The Auchan case is notable for its detailed analysis of facts and elaborate reasoning, which are generally applicable because the case did not relate to tender procedures for entering into a contract.

***Decort v. Auchan* case**

Auchan, as a potential lessee, approached the lessor (Decort) to negotiate a warehouse lease agreement. After the lease agreement was finalised, Auchan delivered the agreement to Decort's representatives for signing. However, after receiving the execution versions of the lease agreement signed by Decort for its co-signature, Auchan abruptly ceased "business contacts" with Decort, although during the negotiations Auchan acted as an entity "strongly intending to enter into agreement with Decort."

In support of its refusal to sign the agreement, Auchan asserted that the lessor, "acting in good faith and reasonably, could and should have foreseen that the agreement might not be concluded" if Auchan failed to obtain the corporate approval of the supervisory board of its parent company or if the lessor failed to provide the bank's consent to the lease agreement.

All courts found that Auchan had acted unfairly when it abruptly and unreasonably ceased the negotiations. The courts' decision was based on the following facts:

- obtaining approval of the supervisory board of the lessee's parent company was not expressly required by the constituent documents of the lessee; and
- the bank's failure to provide its consent by the time of delivery of the execution versions of the agreement was not unexpected by Auchan as the bank had given its consent in principle to the lease, whereas technical delays in issuing the official consent were caused by the actions of Auchan. Therefore, the cessation of negotiations by Auchan, after it had received the execution versions of the lease agreement, due to the lessor's failure to provide the bank's consent was abrupt and unreasonable to the lessor.

Auchan may still appeal the Ruling of the *Arbitrazh* Court of the Moscow District to the Panel of Judges of the Supreme Court of Russia. If the appeal is successful, the judgments handed down in the case may be reversed and the case remanded for a new hearing.

Recommendations

Absent a settled court interpretation of Article 434.1 of the Russian Civil Code, the *Auchan* case serves as an example illustrating the facts that would evidence when the party exiting the negotiations acts unfairly.

In light of the court findings in the *Auchan* case and other cases, the following recommendations may help mitigate the risk of the cessation of negotiations being deemed unfair and the risk of recovery of related losses:

(a) if any corporate or governmental approvals are required prior to the signing of the contract, the counterparty should be notified thereof in advance, especially if the necessity of such approvals is not obvious—e.g., where, as in the *Auchan* case, the obligation to obtain the approval of the supervisory board of the parent company does not expressly follow from law or the company's constituent documents or where the approval is required under a shareholders' agreement;

(b) if a respective corporate body or a governmental authority declines its consent to the contract or if the consideration of that matter is suspended, the counterparty should be immediately informed thereof;

(c) the company should not confirm to the counterparty the company's consent in principle (informal consent) to a contract if the definitive decision to make the contract has not been taken by the company yet;

(d) if necessary, the company can confirm its principal or preliminary consent to certain terms of the contract on the condition that agreement on all other terms of the contract should also be reached and that all internal policies within the company that are customarily required for the final confirmation of the contract should be complied with;

(e) if the signing of a contract is subject to the consent of a superior manager of the company or another person (e.g., beneficiary) who is expected to approve the draft contract prepared by the working group, the counterparty should be notified thereof in advance (especially where the draft contract is to be initialled by the members of the working group before it is submitted to such person for approval);

(f) if the signing of a contract is subject to a number of other conditions (such as completion of legal or financial due diligence; clearance of the draft contract with internal departments of the company; execution of ancillary agreements; obtaining the consent of a bank or another person; provision of certain documents; obtaining a positive opinion of counsel, etc.), the counterparty should be advised of such conditions in advance;

(g) specific circumstances (if any) upon the occurrence of which the company will no longer have commercial interest in the execution of the contract (e.g., failure to sign the contract by a long-stop date; material adverse effect; change of control; change of top management; breach of exclusivity of negotiations; failure to comply with specific covenants, etc.) should be notified in advance;

(h) the counterparty should be promptly informed of any new circumstances affecting the course of negotiations and the execution of the contract;

(i) if the company intends to hold parallel negotiations with several potential counterparties simultaneously, the company should inform them of that in advance and ideally receive their consent to hold negotiations on a non-exclusive basis (or at least to make sure that there is no agreement on exclusivity of negotiations with any of the counterparties);

(j) the signing procedure should be commenced only upon the completion of all pre-signing formalities (including those outlined in paragraphs (a)-(f) above);

(k) if a term sheet or a separate agreement on the conduct of negotiations is made, it should take into account the above recommendations and expressly indicate what arrangements of the parties are legally binding upon them; and

(l) the parties should avoid any partial signing of an agreed set of contracts if all contracts were agreed to be signed simultaneously as one single set (otherwise there is a risk that the signed contracts would be found invalid because of fraud, and the refusal to sign the rest of the contracts would be deemed to be unfair conduct of the party).

The principle of conducting negotiations in good faith applies regardless of whether the parties are legally bound to make a contract (e.g., where there is a preliminary agreement, the parties are bound by a covenant to negotiate in good faith, etc.) or not.

Therefore, it is advisable to follow the recommendations outlined above even if the parties have no legally binding obligations to make a contract.

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We will be glad to answer any questions with respect to this topic.

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