

Risk Management Instruments at a Pre-Contractual Stage

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Introduction

The pre-contractual stage is an initial and important stage in any business. The significance of this stage is determined mainly by the fact that the basis of the future contractual and non-contractual relations is established at this stage.

Every party entering into negotiations must bear certain risks as the parties are free to enter into contract and free to withdraw from negotiations at all, which means that the contract might as well not be finalised. Furthermore, every party entering into negotiations should be aware that negotiations are uncertain by their nature, thus the risks of uncertainty are the part of the game.

In most cases the parties involved are usually forced to employ significant financial and human resources to ensure that the negotiation stage is properly conducted. What happens when the other party (presumably there are at least two parties involved in the negotiations) unreasonably refuses to continue negotiations, or it turns out that the party did not initially even have an intention to complete the negotiations or enter into contract relations? What if this resulted in substantial damage to one of the

parties? Are there any preventive measures against such developments? In this regard the following questions must be answered before entering into the pre-contractual stage:

- a simple gentlemen's agreement would suffice or more sophisticated solutions for aggrieved party's protection and damages compensation should be put in place?
- how not to deliberately defeat the expectations of another party?
- what remedies are available to an innocent aggrieved party?

Although the parties have to be aware that the pre-contractual stage always contains elements of a game, certain obligations could be still imposed upon one of the parties or even upon both of them: to disclose certain information, to take reasonable care, not to mislead the other party. These legal duties could serve as legal grounds for the course of actions.

It should be noted that the issue of pre-contractual liability of the parties involved in negotiations has not been specifically reflected in the Russian legislation or in the case law of the Russian courts. The only instrument recognized by the Russian Civil Code and



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Mediation as one of the instruments for resolving differences at a pre-contractual stage

Mediation may be appropriate for resolving differences arising between the parties at a pre-contractual stage subject, however, to an agreement on the procedure for resolving pre-contractual disputes. Otherwise, mediation is not applicable. As a conflict resolution mechanism, mediation requires consent of **both parties** and a mediator.

It is obvious that mediation is possible only in case when the obligations between the parties arise and even in the total absence of documents between the parties. At the same time, if no documents are signed between the parties (but, assumingly, some correspondence between them is available) and the case is referred to a state court or arbitration, the mediation is possible.

The pre-requisites for using mediation at the pre-contractual stage, include, first of all, a free will of the parties exercised in giving consent to mediation, in selecting a mediator and a right to waive this procedure at any time, and its voluntary execution (that may be reinforced, in some cases, by the state

case law is a preliminary agreement, which could be used only in certain situations enlisted in the Civil Code and only in certain cases it could be enforced by the Russian courts.

Unlike the Russian situation, foreign legal practice consists of a bunch of court cases, confirming the parties' liability in case of bad faith negotiations. But even if positive case law is available in this regard, not every foreign jurisdiction offers legislative provisions on the parties' pre-contractual liability.

Consequently in the absence of detailed legislative provisions on rights and duties of the parties at the pre-contractual stage, either in Russia or in a foreign jurisdiction, it should be strongly recommended to formalize the parties' relations at a pre-contractual stage and to spell them out in specific documents, where the parties might explicitly agree:

- to undertake genuine and good faith negotiations with a view to formulating the basic terms of the contemplated transaction, as well as resolving the dispute or difference, if any, between the parties,
- if they can not resolve the dispute or difference, endeavor to agree upon a procedure to resolve the dispute or difference, and
- to agree on a compensation procedure.

But it should be taken into consideration that enforceability of pre-contractual agreements is different in each jurisdiction. The enforceability of such agreements under the Russian law is doubtful. At the same time such agreements are widely recognized in many foreign jurisdictions.

I. Legal risks to be managed

a) obligation to hold negotiations in good faith

Most of the countries recognize the principle of good faith negotiations, meaning that once the parties have entered into negotiations, they can not prevent the contract from being perfected without **compelling reasons**. In the Russian Federation, there is a general presumption that the parties should exercise their rights in accordance with the principles of good faith, reasonability and justice. Although this principle is not directly included in the Russian Civil Code (further C.C.R.F.), certain articles thereof include such requirements: Art. 6, 10, 602, 662, 1101 etc.

For example, Art. 6 of C.C.R.F. states that: "if it is impossible to use the statute analogy, the parties' rights and duties are determined proceeding from

enforcement instruments, for example, when a mediation award is verified as a settlement agreement between the parties in a Russian court).

Mediation remedies appear to make it possible to recover direct damages from a bad faith party caused to the good faith party in the course of negotiations. In most cases, these are insignificant damages and the final mediation memorandum serves to clarify the procedure for mutual compensation, including the expenses directly related to the mediation itself. Yet, it is very likely that recovery of direct damages incurred at the pre-contractual stage will become a subject of a separate action filed with a Russian court or arbitration tribunal.

As already noted, if a mediation agreement between the parties is verified as a settlement agreement in a Russian court, it may serve as an effective instrument for resolving conflicts, since, as is known, where a settlement agreement is breached, a Russian court issues a writ of execution almost automatically.

Another difficulty in case with a mediation agreement is that mediation often begins when it comes to complex commercial transactions. Dozens of lawsuits are filed with the courts that are not, at first sight, connected with each other in any manner, but, given careful consideration, appear to be components of one and the same complex transaction. Unlike in the previous example, in a complex transaction, a mediation agreement to resolve a dispute (subsequently – a settlement agreement) falls into a series of settlement agreements to be approved at various courts. It is essential that legal techniques should be observed here and the process of conclusion of settlement agreements be synchronized in time.



the general principles and tenor of civil legislation (analogy of the law), as well as requirements of **good faith**, reason and justice”.

Para. 3 of Article 10 of C.C.R.F. stipulates that: “When the law makes protection of civil rights dependent on whether these rights have been exercised **reasonably and in good faith**, reasonable actions and **good faith** of participants in civil relations at law are presupposed”.

Para. 3 of Article 602 of the C.C.R.F. with respect to the disputes arising from Ensuring Lifelong Care states: “When settling a dispute between the parties on the limits of care, which is provided or must be provided to a citizen, a court must be guided by principles of **good faith** and reason”.

Specifically for rental relations, the C.C.R.F. provides that a lessor may be released by a court from the duty of compensating the lessee for improvements, if it proves that the lessee’s expenses on these

improvements increase the value of the leased asset incommensurately to the improvement of its quality and/or service properties or that the principles of good faith and reason have been violated when such improvements were made.

Article 1101 of C.C.R.F. provides that when determining the amount of compensation for moral harm the court shall take into consideration the requirements of reason and good faith.

Even in the presence of such general assumptions, Russia seems to follow the path of designating each type of bad faith conduct and liability for contractual relations, specifying each type of relations (rental, compensation of moral harm, etc), rather than employing the general principle of good faith at pre-contractual stages.

In the absence of general rules of good faith behavior in the Russian legislation, the parties will enjoy less protection against the bad faith behavior



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Certain types of preliminary agreements

Preliminary agreements with respect to assets or subsequent business operations in Russia have crucial importance for and influence positive implementation of the project as a whole.

At a stage of drafting a preliminary agreement, as well as a shareholders agreement, it is important that a preliminary assessment is given to the Russian law requirements regarding the subject matter of the agreement and essence of relationships between the counterparties. The outcome of this analysis will enable the parties to neutralize, to the maximum extent, the risks inherent in the project.

What is to be considered?

First of all, it is necessary to assess the requirements pertaining to the subject matter of the future transaction. For example, with respect to sale of real estate, in addition to conducting due diligence on the facility’s status, it should be noted that, under Part 2, Article 8 of the Russian Civil Code and Article 131 of the Russian Civil Code, title and other property rights in immovable things, restrictions on these rights, their creation, transfer and termination are subject to state registration in the unified state register by the authorities in charge of state registration of real estate rights and transactions.

The **rights to property** subject to state registration arise **from the date of registration** of respective rights to the property.

From the above it follows that, when a preliminary agreement is concluded for sale and purchase of real estate, its terms and conditions should provide for, without limitation, the following:

of the other party during the pre-contractual stage. It seems that the special means of protection tailored for specific contractual obligations can not encompass every possibility, arising from contractual obligations and pre-contractual relations. The Russian legislation lacks the general principles of conducting negotiations, however it contains general assumption that all the parties are acting in good faith.

Certain foreign jurisdictions recognize the general principles of conducting negotiations, such as that the parties should conduct negotiations in accordance with the principles of mutual forbearance among negotiators. The parties are subject to certain pre-contractual duties such as the duty to disclose legal obstacles leading to invalidity of the contract; the duty to inform about all attributable characteristics of the contract; the duty to abstain from breaking off negotiations arbitrarily, if a state of confidence that a contract will be concluded with certainty has been achieved.

However in Russia it seems to be that at the initial stage of negotiations, the traditional aleatory or, in other words, risks theory, under which the parties involved should bear all risks related to negotiations, should remain the ruling theory.

It should be put forward that in the absence of case law or any other legal sources in Russia in this regard, it is most likely to assume that Russian courts will be reluctant to impose any kind of pre-contractual liability on the parties during the initial stage of negotiations, employing the principles of risk theory. But on the other hand, the foreign case law can protect the parties' interests during the pre-contractual stage.

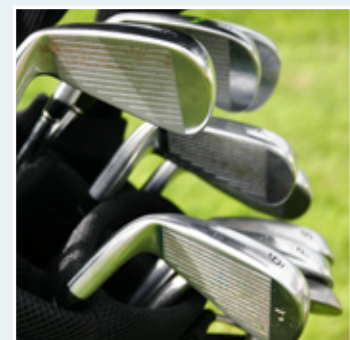
Recent changes in modern international transactions have led to an increased reliance on pre-contractual instruments. Therefore, preliminary agreements are frequently used nowadays, especially in complicated transactions, such as acquisitions and disposition agreements, construction agreements, etc. But when

- 1) the party responsible for the state registration procedures with respect to the facility;
- 2) allocation of costs incurred by the parties in due diligence on the real estate and executing the required registration documents, for example, receipt of up-to-date technical "passports" for the building (structure), land plots, and payment of the government fees.
- 3) the deadline for the responsible party to commence collecting the documents required for state registration. In practice, this stage takes between 1.5 to 6 months depending on the legal status of the facility, availability/absence of technical documents for the assets and other circumstances;
- 4) liability of the parties for failure to fulfill, in full or in part, said obligation under the preliminary agreement.

In practice, at this stage of the pre-contractual process, the liability of either party for breach of the preliminary agreement is set in the form of compensation of all expenses suffered by the non-breaching party. At the same time, no restrictions are imposed by legislation and the parties may agree on detailed description of said conditions.

It should be noted, also, that many types of business activity in Russia are permitted **only if licensed by government authorities**. As a rule, license requirements impose certain conditions on a company, the compliance with which should be confirmed to the government authority, including existence of assets and equipment and qualified personnel. The licensing procedure might take between 1 and 3 months.

In practice, in drafting a preliminary agreement for setting up a company in Russia, whose operations are subject to licensing, it is important to identify the conditions that will enable the company to commence its business operations as soon as possible. It is undoubtedly the management bodies of the newly created legal entity that are responsible for obtaining the requisite licenses. Yet,



the parties use preliminary agreements to allocate the risks of negotiation, the prudence of imposing a general obligation of fair dealing becomes a far more complicated question. Serious problems may arise from different understanding by the parties involved of their intent to be bound at this earlier stage.

Although the practice of using preliminary agreements is quite intensive, the legislation in Russia and some other countries still lacks many formalized provisions associated with pre-contractual relations, leaving therefore the room for the interested parties to designate their rights and obligation in an explicit manner in writing.

b) Breaking off negotiations

Commonly, the pre-contractual stage is featured not only to determine the terms of an anticipated contract, but also, in the first place, to give the parties a possibility to decide whether or not they would like to enter into the contract. Consequently,

the parties are free to break the negotiations. At the same time this freedom should be restrained in the way that such a breaking off ***should not violate the interests of the other party***. Furthermore it should not be done in bad faith, meaning that the party willing to exit should have reasonable grounds to leave negotiations.

C.C.R.F. provides for a general principle that the citizens and legal persons are banned from actions undertaken exclusively with the intention of inflicting damage to other persons as well as from misusing a right in any other form and, in case of violation of this general principal, a court may deny protection of a person who violated this principle (Article 10 of C.C.R.F.). Even subject to this principle it is hardly imaginable that a Russian court will employ this principle for pre-contractual relations, excluding certain cases of protecting parties' interests arising from pre-contractual relations. At the same time the Russian law provides with direct protection in particular cases of pre-contractual relations.



at a stage of negotiating the preliminary agreement on setting up a legal entity, the shareholders (participants) may agree on the most important conditions such as, for example, allocation of costs arising from terminating the project if the license is denied.

The Russian antimonopoly laws provide also for a number of preliminary conditions, compliance with which determines the future of the project. In particular, these conditions include the need to obtain approvals of the acquisition of shares (participatory interest) in Russian companies, participation of foreign companies in Russian entities of strategic importance or acquisition of the right to use more than 1/5 of industrial immovable assets of a Russian company. The general rule is that it takes 1 month to obtain preliminary approval by the Federal Antimonopoly Service of Russia (the "FAS"). The FAS, however, is entitled to extend the time for considering the documents, which may increase the approval period up to 3 to 6 months.

Obtaining a FAS approval involves disclosure of information that is treated as a business secret of both the transaction parties and entities belonging to the same group of companies. Hence, at the preliminary agreement stage, the essential conditions include:

- 1) fixing the consent of the parties to disclose said information to the filing entity;
- 2) specifying the required time costs of preparing the application and FAS approval;
- 3) distributing the obligations and costs of the parties associated with obtaining approvals from the FAS and Government Commission for Strategic Investments.

Once fixed in the preliminary agreement, these conditions will help neutralizing the risks of delays to the project.

Another aspect of the pre-contractual stage includes evaluation of the main provisions on liability of the parties. For example, depending on the contract

Furthermore, the obligation to compensate damages, which is one of the remedies in Russia, can be combined with a court order to enter into an agreement. Taking into consideration the prevailing Russian doctrine that the parties entering into negotiations shall bear all risks, including unreasonable negotiations breaking off, other than the cases and preliminary agreements specifically designated in law, the Russian courts will be reluctant to impose any liability on the parties in negotiations, considering the imposition of any punitive measures as a serious violation of contractual freedom.

As discussed, the C.C.R.F. contemplates pre-contractual liability only in certain cases. For example, Art. 165, par. 4 of the C.C.R.F. states that the party, evading state registration or notary validation of the agreement, is obliged to compensate damages to the other party. This Article is specifically featured for situations when law prescribes to conclude agreements in certain form, in this case it is a notary form, or in cases, when state registration is required

for validating an agreement: immovable property sale purchase agreements, ensuring lifelong care, etc. The Article specifies that, if one of the parties denies to follow the requirements of the law and to finalize the agreement (notarization, state registration), the other party can force this finalization.

There are other cases of bad faith behavior, designated by the C.C.R.F., namely: fraud, coercion, threat, coincidence of grave circumstances. In these cases the court also provides the aggrieved party with the state protection.

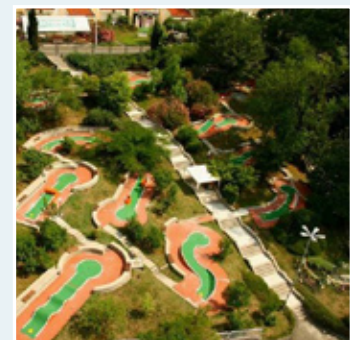
The Russian law does not envisage a general rule prohibiting unreasonable negotiations breaking off. However, Art. 507, par. 2 of the C.C.R.F. provides for special liability for the party evading agreeing on contract provisions and contract perfection. Art. 507, par.1 of the C.C.R.F. provides that, if in the course of concluding a supply contract, disputes over particular contractual terms and conditions have arisen between the parties, the party which has offered to

specifics, the civil legislation enables the parties to agree the conditions other than prescribed by law, which, in practice, makes it possible for them to stipulate regulations different from the ones dictated by law, which can be used to advantage at the preliminary agreement stage, as said conditions must be included into the principal agreement. For example, unless envisaged otherwise in the agreement, the general rule for lease agreements is that, in case of untimely return of the leased property, default interest is to be charged, and losses may be charged in full on top the default interest.

Another example relates to contractor agreements. The general rule is that the General Contractor is liable towards the customer for the consequences of the subcontractor's failure to perform its obligations in full or in part, and towards the subcontractor – for the customer's failure to perform its obligations under the contractor agreement, in full or in part. Unless envisaged otherwise in the agreement, the customer and the subcontractor may not make claims to each other relating to the agreements each of them concluded with the general contractor.

In light of the above, the pre-contractual stage of negotiating the terms and conditions of the principal agreement has significant importance in terms of compliance with effective Russian legislation and minimizing risks that might arise in implementing the project, as already at this stage, the parties have an opportunity to agree on the terms and conditions of the principal agreement, in particular:

- 1) identify the risks inherent in implementing the project;
- 2) envisage the rights and obligations of the parties to the future agreement with respect to the subject matter of the agreement and subsequent activities that will be mandatory for inclusion into the principal agreement;
- 3) identify liability of the parties for failure to perform the principal agreement, in full or in part.



conclude the contract and obtained an offer from the other party to negotiate these terms and conditions must, within 30 days from the day of receiving this offer, unless a different time has been established by law or agreed by the parties, take measures to adjust the respective terms and conditions of the contract or notify the other party in writing about refusal to conclude it.

To secure the pre-contractual relations from such bad faith behavior as unreasonable breaking off of negotiations and to define the type of contractual relations at the pre-contractual stage, a Letter of Intent or Memorandum of understanding can be used, where the parties define the term within which the offer must be replied and all other provisions and characteristics of each stage of negotiations, together with possible remedies, which nature and cases when they must be compensated are explicitly described.

These instruments are widely used in foreign jurisdictions, however, it is still doubtful whether they can be used in Russia, meaning the construction of these instruments under the Russian Law, or whether foreign instruments can be successfully enforced.

c) Non-disclosure

The duty to act in good faith is commonly manifested in the area of information disclosure. Non-disclosure of the facts may constitute a breach of particular provisions of certain laws, if under the circumstances of the case some expectations were created that the party conducting negotiations will disclose certain facts to the other party.

For example, according to the C.C.R.F. and in most countries of the Romano-Germanic system, a contract concluded as a result of error or fraud, when false information was provided, or no information was provided at all, could be pled avoidable (Art. 178, par.2.; Art. 179, par. 2 of the C.C.R.F.). The negative consequences are also stipulated in the following articles of the C.C.R.F. for situations when inadequate information was provided at the pre-contractual stage: Art. 495, par. 3. (damages compensation and withdrawal from the agreement within reasonable time), Art. 613, par. 2 (damages compensation, contract termination, decrease of contract price), Art. 694, par. 2 (contract termination, direct damages compensation), etc. But as it could be seen, the Russian legislation describes only certain



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Recognition and enforcement of the foreign court judgments in Russia

- 1) Recognition and enforcement of foreign court judgments may be seen as a promising avenue for the civil procedure and arbitrazh procedure practice. Respective regulations may be found in the Arbitrazh Procedure Code (Chapter 31, Section VI) and the Civil Procedure Code (Chapter 45, Section V).

It will be noted that enforcement of judgments of foreign jurisdiction authorities is permitted in Russia only to the extent determined by the state in its laws and international treaties through the recognition of legal force of such judgments and expressed consent for using the enforcement mechanism (issuing an enforcement order).

For example, Part 1, Article 409 of the Russian Civil Procedure Code (the "CPC") and Part 1, Article 241 of the Arbitrazh Procedure Code (the "APC") lay down the principle of conventional execution, under which foreign court judgments are recognized and enforced by Russian courts only when such recognition and enforcement are envisaged in international treaties of the Russian Federation.

It should be noted that some scholars deem it possible to have a foreign court judgment recognized and enforced on reciprocity grounds even

cases, when the damages resulting from information non-disclosure can be compensated. In most cases in Russia there are no remedies for such bad faith behavior as non-disclosure.

Under the Anglo-Saxon system of law, a duty to disclose is a part of the notion of misrepresentation. In order to contract, a party has to know all (or almost all) the information and relevant material facts about the agreement the parties intend to reach. For instance in *Bates v Cashman* case regarding the purchase of stocks and bonds of a company, the party would not have signed the contract if it had known that the seller's statement during the negotiations preceding the contract did not correspond to reality. The Buyer has the possibility to rescind a contract if the seller fails to disclose important and relevant material facts or if the seller misrepresents the facts.

d) Parallel negotiations (exclusivity)

The Russian law does not provide for any provisions related to the specific issue of parallel negotiations, the case law lacks any of these decisions as well. The

foreign case law is suppler in this regard. However it should be noted that even in foreign law the issue of whether conducting parallel negotiations counts to lack of good faith in negotiations can not be answered without reference to the circumstances of each particular case. It should be established in each case whether the parties to the negotiations were led by the other party to believe that no parallel negotiations would take place.

In most cases when one party does not rely on the good faith of the other party or wants to protect itself from any negative consequences, the preliminary **agreement on exclusivity of negotiations should be concluded, or relevant terms shall be introduced in the letter of intent and memorandum of understanding.**

The Russian law does not recognize preliminary agreements on exclusivity of negotiations. It is possible to conclude any agreements whose content is not against the Russian law. Under this permission the preliminary agreement on exclusivity of negotiations could be concluded, but its enforceability in Russia is very doubtful.

where no international treaty is signed¹.

It appears expedient to turn attention to the current trends observed in the Russian practice of recognizing foreign court judgments.

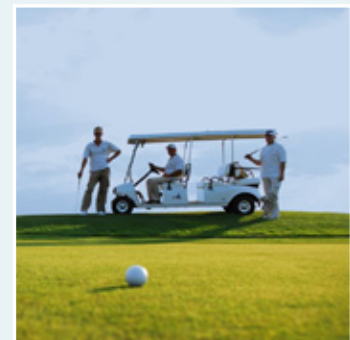
Once widely cited, the Determination of the Civil Chamber of the RF Supreme Court No. 5-G02-64 of 7 June 2002 and subsequent arbitrazh court judgments relating to the case of the Moscow Narodny Bank Limited (London) vs. Scientific Research Institute of **Eye Microsurgery² regarding recognition and enforcement of a foreign court judgment on the grounds of reciprocity and international comity in the absence of an international treaty, is hardly relevant today.**

First, the shy attempts by the arbitrazh courts to direct the vector of legal regulations in this area towards the increased liberality and transparency were influenced by the general mood prevailing at that time – the presented draft APC and CPC, which were, by the way, drafted by the supreme judicial authorities, contemplated reciprocity as the grounds for issuing an execution order along with an international treaty³. Second, following the enactment of the new CPC and APC of 2002, the above case was set for a new trial again <3>, which is a possible evidence of the fact that arbitrazh courts are not ready to recognize a foreign court judgment where no international treaty is available.

¹ A.I. Muranov. *International Treaties and Reciprocity as Grounds for Enforcing Foreign Court Judgments in Russia*. Moscow, 2003.

² See A.I. Muranov. *International Treaties and Reciprocity as Grounds for Enforcing Foreign Court Judgments in Russia*. Moscow, 2003. Pages 90-105.

³ Yet, these provisions were not destined to be included into the final version of the effective CPC and APC of 2002.



e) *Misrepresentation*

Sometimes at the time of negotiations a party wants to convince the other to contract and will mislead with regard to some relevant material facts. Misrepresentation can be defined as an act of making a false or misleading statement with the intent to deceive or mislead someone.

The countries in the Anglo-Saxon jurisdiction recognize the possibility of compensating damages in cases of misrepresentation. To recover the damages caused by such misrepresentation, the misled party has to prove some elements. To have a successful claim the party must prove that there was a "false representation or concealment of a material fact susceptible of knowledge, made with knowledge of its falsity or without sufficient knowledge on the subject to warrant a representation, with the intent to induce the person to whom it is made to act upon it; and such person must act in reliance upon the representation to his damage (Dorris Joni Reed v. Robert J.King).

It is quite doubtful that the Russian courts will compensate the aggrieved party for the damages caused by the unfair behavior of the other party in

negotiations even if an agreement exists establishing the parties' rules of conduct during negotiations. At the same time foreign jurisdictions provide with only limited scope of protection in this regard, where all facts and damages to be compensated are subject to well-grounded proving.

f) *Duty of care*

Duty of care is defined as a duty owned by one party to another to take reasonable care not to cause physical, psychiatric or economic loss or harm. This notion is also applied to the negotiation stage.

In order to prove that one party has failed in its duty of care, several requirements have to be met.

- First, the party's conduct must have been wrongful;
- Second, the aggrieved party has to prove that the other party owns a duty of care to it and the party's conduct fell below the standard of a reasonable person;
- Third, the damage has to be foreseeable.

However the above is true for foreign jurisdictions where the duty of care is recognized as an integral part of the parties' obligations at the pre-contractual



- 2) Regarding the recognition and enforcement of foreign arbitral awards on recognition and enforcement of preliminary agreements, it should be noted that no such judicial practice is currently in place. Yet, it may be assumed that the procedure for recognition and enforcement of foreign arbitral awards will be applicable to preliminary agreements in a similar manner.

Presently, under Russian laws, enforcement of a foreign court judgment is subject to an enforcement order issued by the court that considered the case on recognizing and enforcing the judgment; a different procedure may be prescribed in an international agreement.

- 3) Regarding the Russian arbitrazh courts' practice of considering claims arising from pre-contractual disputes, no such practice was found in place.

Judicial Practice:

1. Review of the arbitrazh courts' practice of considering cases on recognition and enforcement of foreign court judgments, on contesting the decisions of arbitration tribunals and on issuing enforcement orders to enforce decisions of the arbitration tribunals // Information Letter of the Presidium of the RF Supreme Arbitrazh Court No. 96 of 22 December 2005 // Newsletter of the RF Supreme Arbitrazh Court No. 3, 2006.
2. Resolution of the Federal Arbitrazh Court for the Moscow Circuit No. KG-A40/2448-03-P of 19 June 2003.
3. Resolution of the Federal Arbitrazh Court for the East Siberian Circuit No. A58-5134/06-F02-7285/06-S2 of 22 January 2007 in case No. A58-5134/06.

stage. The Russian law is quite reluctant in recognizing this notion, which means that to secure the parties from any losses due to the lack of duty of care the parties will be forced to structure their relations through foreign jurisdictions, but keeping in the mind the imperative provisions of the Russian law, as the country where most of the project will be realized, and the fact that certain provisions of the agreements concluded under the foreign law will not be enforceable in Russia.

g) Duty of cooperation

The duty of cooperation implies two different categories, the good faith in contracts and duty to disclose (the duty of cooperation is more common for the Romano-Germanic system of law). So as it could be seen, the notion includes two elements, which in the Anglo-Saxon system are usually considered separately. Therefore, this duty can be defined as an obligation of the parties to disclose all and any crucial facts related to the subject-matter and substance of the anticipated agreement together with the broad obligation to conduct the negotiations in good faith.

h) Losses resulting from the pre-contractual stage

The freedom of contract principle commands that a party may terminate negotiations at any time or conduct negotiations in any manner it wishes. However, in certain cases exercising such a right to terminate negotiations at any time and to conduct them in any manner may result in damages to the other party. The legislation may not provide for a general good faith duty, which is the case in Russia, and in this case such damages may be considered as irrevocable and non-reimbursable, if pre-contractual relations were subject to the Russian law. Yet, this situation might be cured if the parties (or the party) involved in negotiations took reasonable care and executed a written instrument under a foreign jurisdiction providing that in case either of the parties terminates the negotiations without a reasonable cause, this party is obliged to compensate the aggrieved party for the losses caused by such unreasonable termination.

Another question here is to what extent the losses might be compensated. The Russian law in force says that no losses shall be compensated at all or in better scenario, the losses will be compensated only in limited scope.

Not every jurisdiction is so categorical with regard to pre-contractual damage compensation. In foreign jurisdictions, it is quite clear that the direct damages, proved by the aggrieved party might be compensated, but it is very doubtful that lost profit would be compensated.

II. Pre-contractual written instruments

1. Letter of Intent

Drafting a letter of intent (further referred as "LOI") under foreign law remains the best way to protect parties because they can decide whether or not they want it to be contractually binding, introducing this decision in writing in the text of LOI. To avoid misinterpretation by courts, the Parties should be clear in LOI.

However, when the parties do not indicate their intent to be bound, courts will interpret the intent of the parties in light of the words stated in their documents and the circumstances surrounding the signature of the letter of intent. Most of the time in the Anglo-Saxon system, the letter of intent will be recognized as an enforceable document when it contains all essential terms necessary to constitute a valid contract and of course is supported by valid consideration. At the same time the Romano-German systems accept that there is no requirement for consideration.

Referring to the case law in the Anglo-Saxon system, the letter of intent has to meet the following requirements in order to bind the parties:

- real intention to have the preliminary agreement (letter of intent) binding;
- consideration;
- requirement of certainty;
- the letter of intent shall constitute the **essential terms**.

When the agreement does not specifically contain the intention of the parties to be bound, then the court indicates the importance of acts and conduct of the parties to determine whether there was a contract (*Citizens' Committee of North End v. Hampton*). In some cases the court recognizes even the correspondence between the parties as essential to constitute a valid contract. Indeed, in *Parkview General Hospital, Inc v. Eppes* the parties were bound by their communications which constituted an offer and acceptance.

The parties must agree upon every important part of the deal. The terms of the preliminary agreement have to be definite and clear enough (to avoid ambiguity) (*Lombardo v Gasparini Excavating Co.*, *Linnet v. Hitchcock*) and there must be consideration on both sides (*Stelmack v Glen Alden Coal Co.*, *Cardamone v University of Pittsburgh*).

In case of drafting a Letter of Intent under a foreign law, the requirements of the Russian law shall be taken into consideration, ensuring the enforceability of crucial points. For instance, if the case concerns the project to be implemented in Russia, and the Russian company's stock acquisition will be a part of the project. In the Letter of Intent the parties can make provision on the Russian Federal Antimonopoly Service preliminary approval, of costs and fees, related to such approval application. These provisions shall be made in strict accordance with the requirements of the Russian law.

LOI under a foreign law can be partially compared with a Russian instrument – **preliminary agreement**. According to Article 429 of the C.C.R.F., under a preliminary agreement the parties undertake to conclude in future a contract concerning the transfer

of property, job performance, services provision on the conditions provided for in the preliminary agreement. The Russian law requires that the preliminary contract should be concluded in the form established for the main contract, or in writing, if no form is prescribed. It is important to note that a preliminary agreement should specify the period within which the parties undertake to conclude the main agreement. LOI may also contain the period within which the parties will conclude the main agreements.

As it has been pointed out, LOI should stipulate essential terms of the future agreement, the same story with the Russian preliminary agreement, which should contain the essential terms and conditions of the future main agreement as well. Para 3 of Article 429 of the C.C.R.F. provides: *a preliminary contract may contain conditions enabling to establish the subject-matter, as well as other material conditions of the main contract.*

However unlike in foreign jurisdictions, the Russian preliminary contract is tailored only for limited range of cases enumerated in the C.C.R.F., namely when main contracts are contracts on property transfer,



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Preliminary Agreement under Russian law: practical aspects

Following the latest amendments to the Russian legislation on limited liability companies (LLC) made effective on 1 July 2009, the procedure of transfer of participatory shares in an LLC was significantly changed. In particular, before 1 July, the agreement on sale and purchase of a participatory share in an LLC (SPA) did not require notarization and the participatory share was deemed to be transferred once the company received the purchaser's notice on such transfer. From then onward, the SPA needs to be notarized and it is not legally binding for the parties before its notarization. The notarization signals also the time when rights to the participatory share are transferred to the acquirer.

The above makes it impossible to split signing of the SPA and completion of a deal. At the same time, the gap between signing and completion of the deal is very important for the parties, i.e. it makes them legally bound and liable before the change of control over stakes in a target company occurs. Being legally bound by an SPA, the purchaser may spend its time and resources being aware that the seller does really intend to sell. Under the circumstances the buyer, for example, may require rather a comprehensive due diligence of the target company instead of a limited one, once the seller can be aware that the purchaser is really interested in the acquisition and will undertake this

performance of jobs or service contracts. As it could be seen from the article this document is not a very flexible instrument and could not be employed in complicated cases when many-sided projects' are anticipated. In this case a foreign law LOI would be more suitable.

2. Memorandum of understanding

Memorandum of understanding is a document describing a bilateral or multilateral agreement between its parties. It expresses a convergence of will between the parties, indicating an intended common line of action. It most often is used in cases where parties either do not imply a legal commitment or in situations where the parties cannot create a legally enforceable agreement. It is a more formal alternative to a gentlemen's agreement.

In some cases, depending on exact wording, a MOU can have the binding power of a contract; as a matter of law, contracts do not need to be labeled as such to be legally binding. Whether or not a document constitutes a binding contract depends only on the presence or absence of well-defined legal elements in the text documents (the so-called "four elements").

For example, a binding contract typically must contain mutual consideration - a legally enforceable obligations of the parties and its formation must take place free of the so-called real defenses to contract formation (fraud, duress, lack, etc).

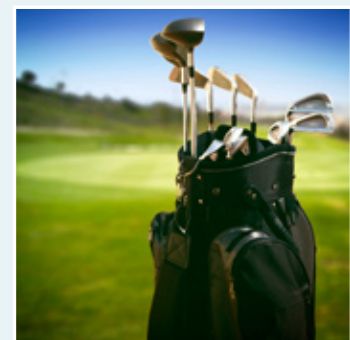
A MOU can theoretically exist under the Russian law, but its form and content are not directly prescribed by the C.C.R.F. and could be established in accordance with business customs and habits. In the absence of case law relating to construction of MOU in accordance to the Russian law, it could be hardly predicted how this instrument, construed under the Russian law will work out in the Russian environment.

However, the practice showed that a MOU construed under the foreign law can actually work out for Russia-based projects. The most discussable case in this regard was the anticipated merger of OJSC "YUKOS" and OJSC "Sibneft". Within the negotiations process, the parties concluded a memorandum of understanding with regard to agreements and transactions to be concluded in the course of the merger. The MOU provided for sanctions (equivalent to 1 billion dollars) in case the parties violate their

examination not for the purposes of unfair competition. The buyer can also get due diligence costs compensated by the seller in case the "quality" of the target company declared by the seller is actually worse and the purchaser decides not to buy it. The seller, in turn, may have enough time to prepare all relevant CPs (conditions precedent) being aware that the purchaser will buy the participatory shares if all conditions of the SPA are reached. Restrictions on the purchaser to refuse the deal without material reasons also allow the seller not to lose market opportunities during the period when the target company is under purchaser's examination.

Given the impossibility to split signing and completion directly in the SPA, the parties will seek the opportunities to get it otherwise. Under the circumstances, we believe that the role of preliminary agreements with regard to the participatory shares sale purchase agreements significantly increases. The participatory shares preliminary sale purchase agreement may allow the parties to reach their goals making them legally bound and liable before the transfer of shares.

However, it is noteworthy that the construction of a preliminary agreement under Russian law is weak enough, allowing any party to such agreement to refuse entering into a main SPA, remaining a good faith party. In addition, although the preliminary agreement may contain provisions on significant fines or reimbursements, it is not a fact that the court upholds the amount of such compensations if the dispute occurs. Thus, the preliminary agreement under Russian law is rather better-than-nothing but not the ideal solution. At the same time such situation under the circumstances might be deemed desirable for either buyer or seller in case it is needed not to go ahead with the deal.



obligation not to break off negotiations without compelling reasons and to negotiate in good faith the conditions of the anticipated transactions.

Another example of a MOU with regard to a Russia-based project was the merger of OJSC “Silovie Mashini” and OJSC “Objedinennie mashinostroiteljnie zavodi”. This MOU also provided for sanctions in cases when the parties would unreasonably break off negotiations.

The instruments similar in their content to a foreign MOU in Russia are named “framework” agreements. They are widely used in business transactions, establishing main conditions for perfection of future agreements in a certain area of business transactions, for instance, framework equipment sale-purchase agreements. These agreements usually contain provisions on supply timing, main conditions of supply (including Incoterms), etc.

3. *Agreements to negotiate in Good Faith*

The main distinction of this agreement from other types of preliminary agreements is that under this agreement the parties are obliged to exert their best efforts to undertake negotiations in good faith and to achieve agreement on the provisions of the anticipated agreement. Concerning the situation in

Russia, a preliminary agreement can be concluded containing essential terms of the main agreement. Bearing in mind that the preliminary agreement to negotiate in Good Faith does not contain any terms and provisions of the main agreement and is mainly featured to rule the parties’ conduct during the negotiation stage, this type of agreements can not be considered as preliminary agreement under Article 429 of C.C.R.F.

In the Anglo-Saxon jurisdictions, agreements to negotiate in good faith encompass a wider range of legal relations and could be enforceable in some circumstances, provided that their terms have been formulated at the sufficient level of explicitly and that reputable legal firms have been employed to draft the agreements.

Under the foreign law, the agreements to negotiate should not be just agreements to agree on the main terms of the anticipated agreement in future. It causes the uncertainty to be avoided in a contract. For this type of agreements the provision on good faith negotiations is essential. It shall leave no room for the parties and court interpretations. Furthermore, it is very advisable that there should be legal advisers employed during the drafting process.

Therefore, simple agreements to negotiate in good faith are likely to be deemed unenforceable by the courts.



As opposite to the above, when dealing with a Russian preliminary agreement, it is necessary to keep in mind that notwithstanding the weakness of this construction it remains binding for the parties and any party may be forced by the court to enter into the main agreement or pay certain penalties to the aggrieved party.

It is also very important to separate entering into the preliminary agreement from entering into the main agreement. For example, when having the preliminary agreement approved by the authorized company’s bodies, especially when the main agreement is attached thereto, we suggest to clearly reflect that the corporate approval of the preliminary agreement does not simultaneously mean the approval of the main one. It will allow the party desiring not to go ahead to refer to the absence of relevant corporate approval as a factor that hinders entering into the main agreement. Otherwise, should the wording of the approval be inaccurate or ambiguous, it is possible that such approval be deemed a proper approval for both preliminary and main agreements that, under the circumstance, may affect the interests of the party willing not to go ahead.

Of course, the preliminary agreement being governed under *e.g.* English law and judged by an English court or arbitration institute, provides the parties with more guaranties, remunerations and higher compensations.

Agreements to negotiate in good faith are more likely to be enforceable if they incorporate some form of a readily ascertainable standard against which to assess whether the parties have acted in good faith.

Even if the “negotiate in good faith” provisions are unenforceable, this does not necessarily prevent it from triggering further dispute resolution procedures.

The courts may imply a duty to negotiate in good faith, although such a duty is unlikely to be an onerous one.

It should be noted that the courts are reluctant to enforce promises to negotiate in good faith, for the reasons of uncertainty, meaning that:

- this will not necessarily undermine the entirety of a dispute resolution clause (Laing O’Rourke v Transport Infrastructure);
- in future, it is possible that the courts will nevertheless imply a duty to conduct negotiations in good faith in limited circumstances (Jobern Pty Ltd v BreakFree Resorts).

Agreement to negotiate in good faith **might be enforceable in some circumstances** (Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd (1991) 24 NSWLR1

In this case the parties promised to conduct negotiations “in good faith to consult together upon the formulation of a more comprehensive and detailed joint venture agreement”.

It was directly suggested by one of the justices that an explicit promise to negotiate in good faith could be certain enough to be legally binding in some circumstances, which could tend to exist when:

- the promise is clear and is a part of an undoubted agreement between the parties, and
- by reference to a readily ascertainable external standard, the court is able to add flesh to a provision.

Application of these principles in two recent cases:

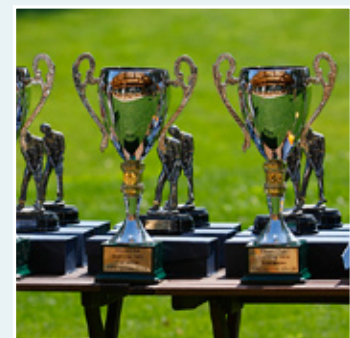
Laing O’Rourke v Transport Infrastructure (2007) NSWSC 723

Explicit provisions on one dispute resolution mechanism (not including litigation) should stipulate that the parties’ representatives must:

- meet and undertake genuine and good faith negotiations with a view to resolving the dispute or difference, and
- if they cannot resolve the dispute or difference, endeavor to agree upon a procedure to resolve the dispute or difference.

In principle, Russian law does not restrict the parties from entering into a foreign law governed preliminary agreement (and also a main SPA) if any party to such agreement is a non-resident person in terms of Russian Civil law that is very common for cross-boarder transactions. In any case, such agreements can be subject to foreign arbitration. The problem, however, is that, to be legally binding in Russia, the preliminary agreement should follow the legal form of the main agreement. Once the main SPA requires notarization, the preliminary agreement notwithstanding to the law it is governed by, shall be notarized as well. At the same time, according to the Russian law, the notary verifies not only the signatures on the agreement but also its compliance with the law. Therefore, currently Russian public notaries refuse to verify the agreements governed by a foreign law and, hence, foreign law governed preliminary agreements and SPAs are not currently usable in legal practice. In the absence of the relevant court practice it is not clear by the moment whether foreign notarization is admissible for such documents.

In case foreign notarization is finally deemed proper in terms of Russian legislation on LLCs, the foreign law governed preliminary agreement will become one of the key instruments for sale and purchase of the participatory shares in Russian LLC. Otherwise, Russian law governed preliminary agreement remains the only instrument allowing the parties to split signing and completion of the deal. In any case, without a preliminary agreement such deals will be very problematic.



Here the concept of failing to negotiate a solution in good faith was still certain enough to trigger expert determination since the contract specifically contemplated such failure to agree.

These issues were also examined by the Court of Appeal in the case *Petromec v Petroleo Brasileiro*. The parties have entered into the agreement for the construction of an offshore oil production platform which had suffered an explosion and fire resulting in it sinking in the deep waters off the coast of Brazil. Under the agreement, Petromec was entitled to be paid the reasonable extra cost of upgrading the vessel in accordance with the specifications together with the reasonable costs of further alterations or changes required by the operator. These additional costs were to be payable on production of evidence of expenditure which, by a term of the contract, the parties agreed “to negotiate in good faith”.

In the event at hand the parties became rather weary of negotiating variation orders separately and decided to try and to negotiate on the basis of a global payment approach. Despite this approach not being envisaged by the express terms of the agreement between the parties, the Court of Appeal

held that an express obligation to negotiate in good faith may be enforceable in such circumstances.

It was also relevant that the agreement between the parties was drafted by reputable solicitors.

4. Shareholders agreement (with condition precedent)

Up until recently (before adoption of the new version of the Federal Law “On Limited Liability Companies” and Federal Law “On Joint Stock Companies”), shareholders agreements could hardly exist under the Russian Law. However, the practice of concluding such agreements (especially with the condition precedent) has not been formed yet and it will certainly take some time to develop it. Therefore, it is rather difficult to predict the case law situation in Russia with the enforcement of the Russian law shareholders agreements.

But if we refer to the legislation of the other countries (namely, to the Anglo-Saxon law), it could be seen that the Shareholders agreements can be successfully enforced partially even in Russia (Here ARBITRAZH’ comments can be inserted).



quite complicated projects, including settling relations within the anticipated project Company with regard to the main terms of the Company's administration (describing main administrative bodies, their functions, necessity, in certain cases, for qualified majority of votes at a general meeting of shareholders, financial issues, deed of adherence, etc), voting capacity of each shareholder, including cases when one share will give more than one vote, exit rights: drag along, tag along, main terms and conditions, where special meaning is given to each term, special representations and warranties, corporate governance of subsidiary companies and many other issues. Unlike in the Russian Federation, where Shareholders agreements are possible only for existing and registered companies, Shareholders agreements in the Anglo-Saxon jurisdictions, for instance, could be set up at the stage, when the real Company has not been incorporated yet, specifying the parties' obligations with regard to the Company's incorporation and other obligations during the pre-contractual (pre-Company) stage. Such agreements are quite widespread and workable. Their main aim is to facilitate the process of complex projects implementation, where several jurisdictions could be involved.

The following provisions could be included in a SHA with conditions precedent:

- timeframe for preparing project documentation (including incorporation documents of the project companies, relevant property transfer or stock transfer agreements, etc.);
- the procedure for charter capital contributions (term, deadline when all contributions should be completed, special procedure for contributions, list of property which could be contributed);
- other financial issues;
- liability in case the parties fail to comply with the document's provision or contributions to the charter capital;
- other issues.

In addition to the provisions specifically drafted for the pre-companies stage, particular provisions could be devoted to the future company's administration. These provisions are deemed not to be valid at the time of signing the shareholders agreement,

however, condition precedent may prescribe that upon a project company's official incorporation these provisions shall come into force. Company's administration provisions should include:

- voting rights;
- dividends distribution;
- execution bodies appointment;
- exit rights;
- pre-emptive rights;
- many others (Anglo-Saxon law is quite flexible so that the parties may include quite a lot of them).

The rest of SHA conditions, which are not subject to conditions precedent such as: obligations to contribute into the share capital of the anticipated company, obligations to finance the project, provision of certain documents, come into the force upon the signing of the shareholders agreement.

5. Effect of Merger clause

The parties may want to include a merger clause, sometimes called an "integration" or "zipper" clause, in their contract. It is a good way to be sure that every single element of their negotiations will be included in their written agreement. The meaning of the merger clause is that all oral arrangements shall be formalized in writing. In case the agreement is not reached in writing, it could not be considered as a part of the binding written instrument.

It seems that foreign courts tend to enforce merger clauses when they result from negotiations between the parties, whereas they do not tend to enforce printed merger clauses in standardized agreements.

Merger clauses aim to protect against the risk that one party will honestly or dishonestly seek to resurrect some proposal that did not show up in the final writing.

Merger clauses are quite widespread in Russian practice either. However the case law in this regard is still not developed. In the absence of steady case law, the practice of merger clause enforcement in Russia is still not reliable.

III. Non written instruments

A) *Anglo-Saxon system of law*

1. Promissory estoppel

The Anglo-Saxon system of law provides for a remedy for the aggrieved party at the pre-contractual stage, which is an obligation arising from justified reliance called promissory estoppel. According to this approach, no one may change its mind to the injury of another party. The idea behind this approach is the principle of fairness and equity. Where one party, the promisor, expects the other party, the promisee, to rely on the promise and the promisee relies that no detriment will be caused, it would be unjust to refuse to enforce the promise (*Miles Homes Div. of Insilco Corp. v First State Bank of Joplin*).

In addition, some courts define this approach as a promise, where the promisor should reasonably expect to induce action or forbearance on the part of the promisee and which does induce action or forbearance which is binding if injustice can be avoided only by enforcement of the promise (*Hinchey v. Nynex Corporation*).

Thus, the promise is binding if the promisee has suffered some detriment in reliance thereon even if this detriment was not requested as consideration.

In order to succeed in a promissory estoppel claim (including claiming damages), the plaintiff has to show three main elements: 1) there is a promise which was reasonably expected to induce action or forbearance; 2) the promise did really induce such action or forbearance; 3) that one party suffered detriment as a consequence (*Viernow v. Euripides Development Corp.*)

Russian law does not recognize any instrument similar to the English law promissory estoppel. The parties, in the course of negotiations, could only rely on the general non-written principle of good faith conduct, bearing in mind, however, that no liability for violation of this principle is prescribed by the Russian law.

It could be recommended that any negotiations be held with involvement of companies incorporated in the English and Wales law or English and Wales law-oriented jurisdictions to protect the parties from bad faith conduct of the other party and even to compensate possible damages.

2. Reliance

There are some situations that occur during preliminary negotiations in which the parties understand that no contract has yet been formed and certain terms are left to be agreed upon, however there is a certain surety or, in other words, reliance that the contract will be perfected soon. Such situation may be called a pre-contractual reliance. In order to allow a reliance recovery in such cases, a court immediately confronts the rule that the promise upon which the promisee relied on must be "clear and definite".

In preliminary negotiations context, the well-known in the Anglo-Saxon law tradition case *Hoffman v. Red Owl Stores Inc.* is important to analyze. Hoffman and his wife as plaintiffs in this case relied on several assurances by authorized agents of Red Owl Stores, the defendant. The parties were negotiating, however, the agreement has never been formed. In this case the court focused on the idea of fairness and equity and how to avoid manifest injustice caused by detrimental reliance. The reliance in this case was not only foreseen by the promisors but also urged upon the promisees. Furthermore, the courts have to look at the circumstances of each case to define whether the remedy of reliance could be employed.

Since the Russian law still considers the pre-contractual stage as the stage where all risks of the parties will be only their own risks, there is no non-written instruments securing the parties from damages which might be incurred during negotiations. Hence, the only suggestion which could be made here is to structure pre-contractual relations through an English-law jurisdiction.

3. Unjust enrichment

The concept of unjust enrichment is based in the law of restitution in both the Anglo-Saxon and Romano-Germanic systems of law. Unjust enrichment means that no one should be made richer through another's loss.

Unjust enrichment has to be distinguished from two principal sources of civil liability at common law: tort and contract. Another term which can be used for the unjust enrichment is "restitution". Nevertheless, restitution is often used to designate any kind of remedy at law or in equity that redress unjust

enrichment. According to *Puttkammer v. Minth*, an action for recovery grounded in unjust enrichment is based on the “moral principle that one who has received the benefit would be unjust”.

In Russia, the law of unjust enrichment may also be applicable to obligations, arising during the pre-contractual stage in cases where no contract has been perfected, but one or more parties, even during negotiations, began to undertake steps for contract performance, relying on one’s expectations that preliminary relations will be ultimately formalized in a contract. Such cases may occur when one party intentionally causes negotiations to break off, or even when a contract was not arrived at for some very legitimate reasons.

The legal provisions on unjust enrichment could be applied only as an ancillary remedy at a pre-contractual stage and only in limited circumstances such as the cases when the parties intentionally abandon the risks theory or also when one of the parties asks the other party to start performing. All circumstances of each case should be carefully scrutinized before implementing an unjust enrichment remedy.

B) Approaches to the nature of pre-contractual liability in the Romano-Germanic systems of law

The following are the main approaches existing among practitioners as to the nature of the pre-contractual liability.

In German law, pre-contractual liability is considered to have the same nature as contractual or quasi-contractual. It departs from the notion that the party in default breaches a good faith implied contract.

In France, pre-contractual liability refers to the tortious liability theory.

In the Russian Federation, the question about the nature of pre-contractual liability, when the legislator allows the possibility to impose such liability on the parties, still remains open. But it is supposed that when choosing between contractual and tortious theory of pre-contractual liability, the choice should be made in favor of the tortious character. However, since the pre-contractual liability has a specific nature when compared with the classical tortious theory, a pre-contractual liability has a quasi tortious character.

It should be further noted that the obligations closest to the *culpa in contrahendo* institute mostly accepted in Germany as a leading theory, are the conditional¹ and tortious obligations. Unlike conditional obligations, the pre-contractual liability is not based on unjust enrichment or illegally detention of property. The default party here does not have any proprietary benefits. Furthermore, the default party does not directly undertake any specific activity, causing damages to the other party. It is the suffering party who is to provide the default party with certain information and rely on its good faith behavior. The absence of explicit damages distinguishes pre-contractual liability from tortious liability. The common characteristic of all types of liability is that all of them are described by the law in different level of specification.

In procedural law, the question of how conditional, tortious and *culpa in contrahendo* suits should match each other, could not be resolved only by means of the applicable material and procedural law. It seems that this claim should have some ancillary character and should be employed only in such cases when no other legal grounds exist (such as tort or contract), supporting the legal claim, but good faith of participants should be protected.

¹ **Conditional** - from latin **CONDUCTIO INDEBITI** - an action in civil (Roman) law whereby a plaintiff may recover what he has paid the defendant by mistake



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Conclusion

As it has been discussed in details, Russian legal reality, unfortunately, can not provide the parties with reliable instruments of defense of their interests for each case of pre-contractual difficulties, which might occur. The existing legal instruments of pre-contractual defense, such as preliminary agreements can be used only for certain types of legal relations and, regrettably, can not encompass all details of the legal reality. Even when the law directly provides with a special defense for an aggrieved party (state supply agreement, supply agreements, etc), the latter can mostly resort to such a legal remedy as compelling to conclude an agreement, when the damages can be only limitedly compensated. This remedy will not always be of interest for the parties by the moment the negotiations have been broken off. In most cases, damages compensation of full value will be more relevant.

In practice the parties are frequently forced to refer to foreign jurisdictions, seeking to properly defend their interests during the pre-contractual stage, especially if its concerns the situations with big cross-boarder transactions.

Use of written instruments of defense of the parties' interests may also quite effectively minimize the parties' risks at the pre-contractual stage, and in certain cases ensure compensation of damages. However, it is recommended to structure the parties' relations through foreign jurisdictions and employ foreign law (e.g. English Law) as applicable, but always bearing in mind that structuring relations through foreign jurisdictions, and at the same time aiming development of business in Russia, the parties should always take into consideration the provisions of the Russian law. Should the imperative provisions of the Russian Law not be properly observed (e.g. license, state permissions obtaining. etc) it may hinder the implementation of the project in the whole.

There is quite a broad range of written instruments for pre-contractual risks management. Any party entering into negotiations, having consulted a professional lawyer, may choose one the most suitable instrument, or even combine the elements of different instruments, if the circumstances allow.

Risk management instruments on the pre-contractual stage

Instrument	Risks to be managed										
	To hold negotiations in good faith	Obligation to disclose certain information	Unreasonable breaking off the negotiations	Obligations of confidentiality	Not taking reasonable care	Misleading the other party	Losses, incurred as a result of a pre-contractual stage	Lack of cooperation	Parallel negotiations (exclusivity of negotiations)	Misrepresentation	Honestly or dishonestly seeking to resurrect some proposal (arising during the negotiations, but that did not show up in the final writing
I. Pre-contractual agreements in writing:											
1. Letter of intent	+	+	+	+	+	+	+	+	+	+	-
2. Memorandum of understanding	+	+	+	+	+	+	+	+	+	+	-
3. Agreement to Negotiate in good faith	+	+	+	+	+	+	+	+	+	+	-
4. Shareholders agreement (with condition precedent)	+	-	+	+	+	+	+/-	-	-	+	-
5. Effect of Merger Clause in the final agreement	-	-	-	-	-	-	-	-	-	-	+
II. Non-writing instruments:											
<i>a) Anglo-Saxon system of law</i>											
1. Promissory estoppel	+	-	+	-	+	+	+	+	+/-	+	-
2. Reliance	+	+	+	-	+	+	+/-	+	+/-	+	-
3. Unjust enrichment	+	-	+/-	-	-	+	-	-	+/-	+/-	-
<i>b) Roman-Germanic system of law</i>											
1. Tort responsibility for lack of good faith	+	-	+	+	+	+	+/-	+/-	+/-	+/-	-

+	manageable
+/-	Manageable/Not manageable (depending on circumstances)
-	not manageable

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