

## Mala fide negotiations: Auchan is to pay RUB 15 million of damages

Newsletter

27 December 2017

The Russian legislation provides that parties should negotiate bona fide. Should they fail to conduct negotiations in good faith, the breaching party is to pay damages. This was in the case Auchan LLC v. Decort LLC, when the latter claimed over RUB 15,6 million (approximately EUR 226 000) of damages resulting from bad faith of the contracting party. Held, Auchan LLC was liable for wrecked negotiations and obligated to pay the whole sum of lost profit.

This case is one of the first steps in judicial defense of bona fide contracting parties, where such a large sum of damages was awarded. Thus, we can assume formation of the respective court practice, therefore, it is essential to improve negotiation tactics in order to avoid unreasonable costs.

### 1. FACTS OF THE CASE

**Decort LLC** (hereinafter also “the Claimant”) and **Auchan LLC** (hereinafter also “the Defendant”) were negotiating a lease contract over a warehouse in Moscow region. The parties had already agreed upon the final text of the contract, the latter being signed by the Claimant. Moreover, the Defendant was monitoring formation of the contract and transfer of the signed copies to Auchan LLC.

However, upon receipt of the signed copies of the contract from the Claimant, the Defendant terminated the business relationships with the Claimant. Before that, the Defendant had held itself out to have a settled intention to make a contract with the Claimant: when negotiating fundamental terms of the contract, the Defendant carried out legal and financial analysis, requested documents, agreed on commercial and technical terms on the agreement.

### 2. THE COURT DECISION

The court referred to Article 434.1 of the Civil Code of the Russian Federation, which sets forth that when entering into negotiations for making a contract, parties shall act in good faith in the course of negotiations and upon their completion. Sudden and unjustified termination of negotiations, which could not be reasonably expected by the other party, amount to actions in bad faith. Therefore, the breaching party shall compensate the injured party damages, which include actual damage and loss of profit.

The court of the first instance held the Defendant liable for mala fide breach of the negotiations and adjudged over RUB 15,6 million of damages to the Claimant. The courts of appeal and

cassation upheld the decision.

However, the case can come to trial in the Supreme Court of the Russian Federation, which may quash the decision.

### 3. DEFENSES

- ▶ The Defendant argued that the Claimant could reasonably assume the possible termination of negotiations for there was no duly executed corporate approval of the transaction.
- The court dismissed the defense. Held, that neither e-mail correspondence, nor other evidence demonstrated that that parties had discussed the corporate approval as an obstacle for formation of the contract. Moreover, as a rule, a corporate approval precedes making a contract.
- ▶ The Defendant argued that the Claimant had terminated the lease contracts with the former lessees willingly by agreement, for which the Defendant was not liable.
- The court dismissed the defense. Held, the Defendant was liable not for termination of the lease agreements by the Claimant but for conduct of negotiations in bad faith as a continuous and single process, which had cause-and-effect link with the Claimant's damage (uncollected rental payments).
- ▶ The Defendant argued it had been acting in good faith during the negotiations, the latter being interrupted due to objective factors, namely **absence of a corporate agreement** by the supervisory board of Auchan Group and the Claimant's **failure to provide the Bank's consent to the lease contract** at the time of transfer of the signed copy of the contract to the Defendant. The Defendant declared it had informed the Claimant about necessity to negotiate the contract with the supervisory board of Auchan Group, therefore interruption of negotiations was not sudden and unjustified.
- The court dismissed the defense. The Defendant did not provide evidence certifying that it had duly notified the Claimant on need to have the supervisory board of Auchan Group agreed on the contract: it appeared from the letter of intent, addressed to the Claimant, that the supervisory board's consent was required for the terms of negotiations, but not for the transaction resulting from such negotiations.
- Moreover, the Claimant failed both to provide minutes on denial of the transaction from the supervisory board of Auchan Group and to prove the existence of such a governing board and its authority to approve of transactions.



**The Defendant's subsidiary was expected to become lessee under the contract. Held, due to peculiar relations between a subsidiary and a parent company, Auchan LLC was acting in its own name and economic interest during the negotiations.**

- The court also held that the Defendant was acting in bad faith when it submitted the signed lease contract for approval by the supervisory board not having waited for execution of the bank's consent. It was specifically stressed that the Defendant was aware that the supervisory board would not approve of the transaction absent the banks' consent.

#### 4. CONCLUSIONS

The court practice aimed at protection of bona fide contracting parties at the pre-contractual stage is currently forming. Unlike previously, the parties should now take into account that bad faith negotiations may result in serious sums of damages to be paid to the aggrieved party.

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