REVIEW OF FOREIGN EXPERIENCE IN MINIMIZING CONTRACTUAL RISKS

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https://doi.org/10.5281/zenodo.8260891

Annotation

The paper in a comparative legal context analyzes the practice of minimizing contractual risks in such countries as England, the United States, Germany, Russia and Uzbekistan. Particular importance is given to the doctrine of estoppel as an effective mechanism of protection of a bona fide counterparty, and the prospects of introducing this tool into the legislation of the Republic of Uzbekistan are examined. The paper is aimed both at lawyers of the sphere and at readers of a wide range as it based on theoretical and practical research.

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Keywords: contract risk assessment system, the principle of good faith, counterparty, bona fide counterparty, estoppel, legal due diligence, impossibility of performance, USREO, “understandable” contract.

This article raises the question of whether promises can have legal force and serve as a basis for a claim if one party makes a promise with the purpose of making the other party act, and the second party actually began to act in reliance on the promise. The legislation of the Republic of Uzbekistan does not provide for such an instrument, but it exists and operates, and effectively, in a number of foreign legal systems.

In English law, it is estoppel. It was created in its present form by a decision of Judge Lord Alfred Denning in Central London Property Trust Ltd v. High Trees House Ltd in 1947. High Trees House Ltd in 1947[1]. Let us analyze this case in order to understand the essence of the doctrine of estoppel. The case was as follows: Central London Property Trust Ltd (hereinafter the Claimant) was the owner of a residential house. This house was leased to High Trees House Ltd (the Defendant) who had the right to sublet the house. The lease was for 99 years commencing in 1937 at a rent of £2,500 per annum. But in 1939, however, due to the outbreak of the Second World War, people began to leave London in masse and the house was only one-third occupied. Because of this circumstance, the leaders of the parties in 1940 as a result of negotiations came to an agreement to reduce the amount of rent payments to 1250 pounds per year. The agreement was set forth in writing. The landlord subsequently confirmed the agreement by separate letter[2]. Since then, invoices have been issued for £1,250 instead of £2,500.

[1] Casebook on Contract law by Jill Poole, 13th edition – Oxford University Press, 2016 – p. 125 Available on:
URL:https://books.google.co.uz/books?id=5E1DAAAQBAJ&pg=PT3&hl=ru&source=gbs_selected_pages&cad=3#v=onepage&q&f=false

[2] Orobinsky V.V. English contract law: - Rostov n/D: Phoenix, 2019. - p.158.

In all probability the parties changed the rent as a temporary measure for the period of hostilities, but their agreement had no clauses in case the house was subsequently fully occupied.

"In March, 1941, the plaintiff's creditors appointed a receiver who has since managed the plaintiff's affairs. Both before and after the appointment of the receiver the defendant paid rent at a reduced rate, and in one hard year it could not pay even that amount - it paid even less. Meanwhile, in 1941, 1942, 1943 and 1944, the defendant paid £1,250 per annum". In 1945 the house was fully occupied, but the defendant was still paying the undervalued amount.

In September, 1945, the receiver learned that the amount of the rent under the main lease was £2500 per annum. He then wrote a letter to the defendant demanding payment of the full amount of the 1945 payments and also payment of debts totaling £7,916. The defendant had failed to fulfill his obligations and the receiver took legal action. But first he decided to check the position of the legislator and stated in the suit the amount of recovery in the amount of 1250 pounds for two quarters.

The defendant had two positions:

- the rent abatement is effective for the entire 99 years of the lease;
- the rent abatement is valid until September 1945 (in case the first position is not upheld).

In English law, the doctrine of counter-provision is of great importance: the party granting the assignment must receive something in return. But since in this case, with the supplemental agreement, the plaintiff received nothing in return for the reduction in rent, accordingly the supplemental agreement is void.

But Judge Alfred Denning made the following reasoning a key point in his judgment: the plaintiff promised the defendant to reduce the rent, and the defendant acted reasonably in reliance on that promise. Accordingly, such a promise was enforceable. This legal remedy is called promissory estoppel. Based on the judge's ruling, it follows that the following elements must be present for estoppel to apply:

1) Party A made a certain promise to Party B;
2) Party B acted in reliance on Party A's promise;
3) Party B reasonably relied on Party A's promise (objective test).

It should be noted that the claim in this particular case was partially satisfied: the defendant was charged the amount originally set out in the contract only for the year 1945 (when the circumstances that served as a basis for changing the rent had ceased to exist).

The doctrine of estoppel (there are other types of estoppel in addition to promissory estoppel), despite its Anglo-American origin, has been quite successfully recirculated into the Romano-Germanic legal family. However, in the continental family this doctrine is better known as a supplement to the principle of good faith. For example, paragraph 5 of Article 166 of the Civil Code of the Russian Federation, devoted to void and voidable transactions, states:

A declaration of invalidity of a transaction shall have no legal value if the person invoking the invalidity of the transaction acts in bad faith, in particular, if his behavior after the conclusion of the transaction gave grounds for other persons to rely on the validity of the transaction.[3]

[3] Civil Code of the Russian Federation (Part One) of 30.11.1994 N 51-FZ (ed. of 25.02.2022). URL:http://www.consultant.ru/document/cons_doc_LAW_5142/44c14b6900a9357b7280c62327f3bfdf1743a52c/

Estoppel is also reflected in a number of other norms of the Civil Code of the Russian Federation, in particular, in Article 166.2, Article 432.3, Article 450.1.5 of the Civil Code[4].

The doctrine of estoppel is also actively applied in the German legal system. Thus, it was vividly reflected in the famous "scrap metal dump" case, which was considered by the Federal Supreme Court of Germany in 1952[5].

Its essence was as follows: "A scrap metal trading company tried to take a long-term lease from the municipality a land plot of 10 thousand square meters. The parties conducted negotiations. As a result, the company accepted all the terms and conditions of the municipality and signed the contract provided to it by the municipality. The contract was approved by all necessary authorities on the part of the municipality and the only thing left to do was to formally sign it. The municipality officially authorized the company to start using the site before the contract was signed, and the company started dumping scrap there.

However, despite all the company's reminders, the municipality delayed signing the agreement - as it turned out later, expecting to find a more profitable tenant. A year later, a large company did become interested in the site, after which the municipality made a final decision to refuse to sign an agreement with the company and demanded that it vacate the site[6]

The doctrine of estoppel in Germany has evolved into the doctrine of pre-contractual liability (Verschulden beim Vertragsschluss), and the company's claim was granted precisely because it was based on this doctrine. However, the argument that the doctrine was inapplicable to public bodies was soundly rejected by the court. Analyzing the Chief Justice's words in the body of the decision, one can conclude that it is a classic doctrine of estoppel:

"The defendant culpably failed to inform the plaintiff that the contract was not finalized. Instead, and with the obvious intent to avoid incurring obligations in order to offer the site to a more favorable counterparty if possible, it delayed the submission of the contract in final form. By his assertions that everything was in order and that the contract could be considered concluded, the defendant created in the plaintiff the belief that the lease had indeed entered into force and that the written form was irrelevant"[7] .

In the Federal Republic of Germany, a type of estoppel - assurance (estoppel by representation) - was applied in this case. It usually arises from a verbal assurance, but sometimes such an assurance may be given by non-verbal behavior indicating that the person to whom the assurance is made must be convinced that something has happened or is

[4] Karapetov A.G. Estoppel on contestation of the contract under item 2 of article 431.1 of the CivilCode.
[5] BGHZ 6, 330 V. Civil Senate (V ZR 34/51) [Electronic resource] The University of Texas at Austin. URL: https://law.utexas.edu/transnational/foreign-law-translations/german/case.php?id=879
URL:https://zakon.ru/blog/2016/6/7/estoppel_na_osparivanie_dogovora_po_p2_st4311_gk
[6] Budylin S. Tort or breach of contract? Assurances and Guarantees in Russia and Abroad // Draft article.
URL:https://zakon.ru/blog/2016/1/29/delikt_ili_narushenie_dogovora__zavereniya_i_garantii_v_rossii_i_za_rubezhom
[7] Budylin S. Tort or breach of contract? Assurances and Guarantees in Russia and Abroad // Draft article.
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happening by the time of the assurance. In Jorden v. Money (Jorden v. Money[8]), decided in 1859[4], the court found that this estoppel requires some sort of past and present statement, but does not extend to promises relating to future conduct or refraining from such . The FRG modified this doctrine somewhat, as the contract was not found to have been concluded, but the injured party, who acted in good faith, was entitled to full damages. The aforementioned promise-based estoppel applies in the FRG in public relations, particularly in administrative law.

In other words, while in English law estoppel is a defense that gives the promise legal effect (a kind of "shield", as one cannot sue on the basis of estoppel, but can only defend against invalidity), the German doctrine of pre-contractual liability is a defense that gives the right to recover damages (a kind of "sword", as it can serve as a cause of action even in the case of non-concluded contracts).

In certain legal systems, such as the US or Australia, the doctrine of English estoppel has developed considerably. Thus, in the USA, estoppel may be used not only as a measure of protection against the recognition of a transaction as invalid or non-concluded, but also as a basis for an independent claim.

Thus, we see that the doctrine of estoppel has become one of the fundamental legal doctrines, which is reflected in many leading legal systems of the world, and it should be noted that it has influenced not only domestic, but also international contract law. Active implementation of this doctrine several years ago began in neighboring Kazakhstan[10].

The reason why the doctrine has become so widespread is its formation of fair business relations. Estoppel, by promoting fairness and measures against unscrupulous businessmen, has become the main driver of stable and predictable contractual relations.

The next aspect of the study of international contract law experience will concern the verification of counterparties. In Chapter 2, Section 2.1. of the thesis, it was noted that many countries, including Uzbekistan, have introduced a system of national counterparty verification.

However, many countries have not stopped there. Given that the modern community is moving towards globalization, the topic of contractual relations with foreign counterparties is becoming more and more relevant. Moreover, fraud has become an international phenomenon quite actively. Often the victims of such fraudsters are naive individuals and legal entities, who do not even think about whether there is actually a foreign company with which they want to conclude a contract.

As a result, the damage of such naive counterparties often becomes multi-million dollar, sometimes exceeding reasonable amounts. And very often, when law enforcement authorities get involved in the case, it turns out that it is too late and the money cannot be recovered.

[8] См. Dutson S. Product Liability and Private International Law: Jurisdiction in International Product Liability Litigation [Electronic resource] // Bond Law Review. 1997. Vol. 9. № 1. URL: http://epublications.bond.edu.au/cgi/viewcontent.cgi?article=1124&context=blr

[9] Neil Andrews. Contract law. // Cambridge University Press, 2011, page 167.

[10] Suleimenov M.K. English law and the legal system of Kazakhstan // Bulletin of the Institute of Legislation and Legal Information of the Republic of Kazakhstan. 2015. №5 (41). URL: https://cyberleninka.ru/article/n/angliyskoe-pravo-i-pravovaya-sistema-kazahstana

In order to protect their citizens and legal entities from such situations, many states have begun to create various systems which, in an organized manner, provide information on foreign counterparties from the official registers of their states.

For example, the site of the Russian USRLE (Unified State Register of Legal Entities) provides information from official registers of more than 250 countries. The system of issuing extracts from the official registry sites of foreign countries is carried out on the basis of a reselling agreement (purchase and sale of infoproducts), such as with the European Business Register. Information from company registries of other countries is open and publicly available and is provided on the basis of respective user agreements.

The United Kingdom has made the checking of foreign counterparties more for orientation rather than as a full-fledged service. The official Companies House website provides links to the official registers of a number of foreign countries, but this list is limited to English-language sites. Moreover, the site makes a disclaimer that it is not responsible for the accuracy and completeness of the information that may be obtained from the links provided[11] .

The European Union has developed a good online counterparty verification platform for traders from its member states. In accordance with Directive 2012/17/EC, the service covers the business registers of all EU countries as well as Iceland, Liechtenstein and Norway. In addition, the site also contains official links to the public registers of EU countries[12].

The USA has also developed a fairly effective system for checking foreign counterparties. They have even gone further: in order for American businessmen to understand the market and conditions of foreign countries, they have developed a centralized platform with specialized guides for them. In addition, the website also has recommendations for foreign business partners who would like to establish connections with partners from the United States. The International Trade Administration is responsible for all the processes involved in establishing business relationships between the U.S. and other foreign countries[13].

The above mentioned ways of checking counterparties bring us closer to the well established in case law concept of due diligence, which is gaining wide popularity today. Due diligence refers to the process during which an individual or organization searches for sufficient information about a commercial legal entity to form an informed judgment about its value for a particular purpose.

Due diligence is conducted in various situations: in the course of a takeover, obtaining a loan, investing, preparing a merger proposal, evaluating the value of a company's division, sale, etc. Legal due diligence can help avoid legal and regulatory pitfalls by identifying and mitigating them at the initial stages of a transaction.

[11] Data from Companies House. URL: https://www.gov.uk/government/publications/overseas-registries/overseas-registries

[12] Business registers – search for a company in the EU. URL: https://e-justice.europa.eu/content_find_a_company-489-en.do

[13] International Company Profile (Full and Partial). URL:https://www.trade.gov/international-company-profile-0

According to M. Bukashin and S. Pochaev legal due diligence "is a procedure for identifying legal risks in order to determine the commercial attractiveness of a planned transaction for the acquisition of any company asset, land plot, real estate object..."[14].

Maxim Mozgov, Head of due diligence branch at Egorov, Putinsky, Afanasiev & Partners, at the seminar "Corporate Transactions: Current Legal and Practical Issues" highlighted the main blocks for due diligence of an acquired company:

1) corporate history of the company (correctness of actions during the establishment of the company, registration of contributions to the authorized capital, distribution of competencies between management bodies);
2) property rights (immovable and valuable movable property);
3) intellectual property;
4) employment agreements;
5) existing disputes (including at the pre-trial stage);
6) economic contracts.

Thus, summarizing the above we can note that each country, one way or another, tries to protect its entrepreneurs from the risks of international trade, namely from unscrupulous partners. After all, every country realizes that if it will actively promote business relations with trusted and honest counterparties, it will be a guarantee of safety of financial assets and ensure the stable development of trade relations with foreign partners. In turn, this will attract foreign currency into the country, increase the volume of exports and in general will have a very favorable effect on the country's economy. Therefore, investing in this area will be a win-win solution.

[14] Nechukhaeva O.V. The concept of due diligence (legal due diligence) // Modern Science. 2016. №1. URL: https://cyberleninka.ru/article/n/ponyatie-kompleksnoy-yuridicheskoy-proverki-legal-due-diligence

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