

Hot topic:

The consequences of a lessee's refusal to accept property under a lease agreement: the new practice of the Supreme Court of the Russian Federation



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On June 26th 2020, the Ruling of the Supreme Court of the Russian Federation no. 305-ES20-4196 was published. The Decision is dedicated to important issues of forcing the lessee to fulfill its obligations to the lessor, under a real estate lease agreement. The legal position of the Supreme Court should be taken into account when structuring lease transactions, including the built-to-suit lease agreements.

This is especially important when we speak about the remedies of the lessor, in cases of a lessee's refusal to accept the subject of the lease.

Russian law provides for such a remedy, as the enforcement of obligations by a breaching party (specific performance). However, it is not enforceable in the case when the lessee refuses to accept the rented property, according to the position of the Supreme Court of the Russian Federation.

FACTUAL BACKGROUND OF THE CASE

The lessee and the lessor had entered into a short-term, real estate lease agreement. Under the terms of the agreement, the lessee was obliged to accept the premises by August 27th 2018, and pay the first part of the security payment (deposit) – by September 9th 2018.

On August 19th 2018, the lessee sent the lessor a notice of termination and refused to sign the acceptance and trans-

fer certificate in respect to the premises, despite the provisions of the lease agreement. The lessee has also refused to pay the security payment.

Since the lease agreement did not provide for a right of the lessee to withdraw from the agreement unilaterally, the lessor filed a claim to compel the lessee to accept the premises, to pay the security payment and a penalty for the delay of payment.

POSITION OF THE LOWER COURTS

The court of first instance satisfied the lessor's claims in full, saying that the lessee shall accept the premises and pay a security payment (articles 309 and 421 of the Civil Code of the Russian Federation). It concluded that there was an enforceable obligation of the lessee to accept the property. Since it failed to perform this obligation, the court could compel the lessee to perform it, in the manner prescribed by the lease agreement.

The courts of appeal and cassation have upheld this decision.

WHAT DECISION DID THE SUPREME COURT OF THE RUSSIAN FEDERATION MAKE?

The Supreme Court disagreed with the lower courts. According to the Supreme Court position, because of the nature of

the obligation to transfer the leased property, it cannot be enforced against the lessee, using the claim of the lessor under Art. 308.3 of the Civil Code. If the lessor does not fulfill its obligation to transfer the property, then the lessee may have recourse to a claim for specific performance and enforce the transfer of the leased premises under the lease agreement. Specific performance, however, is not available for the lessor if the lessee refuses to accept the property. Thus, in this case, the lessor has to use other remedies.

In this situation, the lessor has only a few remedies (if no other remedies are agreed, between the parties, in the lease agreement):

- termination of the contract, at the initiative of the lessor, in court;
- compensation for damages caused by the unlawful refusal of the lessee to accept the leased premises (which is considered by the Supreme Court as the creditor's delay, within the meaning Art. 406 of the Civil Code).

In relation to the security payment, the Supreme Court concluded that, as the lease agreement provides that this payment might be set-off against damages caused by the lessee, the court cannot compel the lessee to make a security payment, in addition to compensation of damages. Thus, in this particular case, the appropriate remedy is recovery of damages.

Taking into consideration the above-mentioned decision of the Supreme Court, the parties to the lease agreement, especially in case of built-to-suit lease agreements, or agreements in respect to future leased premises, shall carefully consider their relationships and agree specific remedies in order to address and mitigate respective risks.

We may recommend the following to the lessors:

- The contract should provide for a penalty (neustoyka) in a case of lessee's refusal to accept the rented property. Such a penalty can be established as a lump sum, or accrue for each day of delay.
- It is recommended to introduce provisions regarding the right of the lessor to unilaterally withdraw (terminate) from the contract, in case the lessee refuses to accept the leased property, or does not accept this property, during the prescribed period. The contract shall provide the right of the lessor to claim a penalty (neustoyka) as a consequence of such termination of the contract (whether in addition, or in lieu, to the lessor's damages, caused by termination of the lease contract). In such a case the lessor should have a right to retain the security payment (if paid prior to termination) on account of such penalty (neustoyka).
- Lessors should also consider the possibility to obtain an irrevocable power of attorney from the lessee, providing for a right to sign an acceptance certificate, on behalf of the lessee. It will significantly reduce the lessor's risks associated with the lessee's refusal to accept the rented property.
- The lease agreement should specify the procedure of transfer of the rented property in greater detail, including issues such as notifications, eliminating defects identified by the lessee, the list of documents to be signed at the transfer, period for transfer and so on. The lessor should strive to eliminate any uncertainty regarding the transfer of leased property. Some provisions on the unilateral transfer of property by the lessor, in a situation where the tenant is passive, might be introduced.