NJORD case law news: The Senate has adopted a judgment on the legal nature of a preliminary contract

On 5 July 2023, the Senate of the Republic of Latvia adopted a judgment in case No. SKC-19/2023, where the Senate considered such issues as the legal nature and essence of a preliminary contract (in Latvian – "priekšlīgums"), the right to claim performance of a preliminary contract and to combine such a claim with a claim for performance of the main contract.

In the main proceedings, the insolvency administrator of the insolvent JSC "Rīgas Vagonbūves rūpnīca" brought an action in court against JSC "Pasažieru vilciens", seeking, inter alia, that the parties' contract for the purchase of 49% of the shares in JSC "VRC Zasulauks" be recognised as concluded, that the value of the shares be fixed at EUR 905 340 and that the defendant be ordered to pay the value of the shares in favour of MAS "Rīgas Vagonbūves rūpnīca". The parties had signed a shareholders' agreement (the "**Agreement**") on the purchase of the shares from the claimant, stipulating, inter alia, that the value of the shares to be sold, to be determined by an independent valuer, should be as high as possible and "should be in line with the parties' understanding at the time of its amount of approximately EUR 700 000, taking into account the value of the company's total assets, the contracts concluded and business opportunities."

Pursuant to the terms of the Agreement, the management of AS "VRC Zasulauks" was transferred to the respondent, while a valuer was engaged to determine the value of the shares and concluded in a report (the "**Report**") that the value of the shares to be sold was approximately EUR 200 000 higher than the approximate value of the shares provided for in the Agreement. The respondent refused to pay the purchase price of the shares in accordance with the value of the shares as set out in the Report, stating that a new valuation of the shares to be disposed of should be carried out. The respondent has also rejected the amount of EUR 700 000 set out in the Agreement, stating that, according to the valuer it has called in, the shares are worthless at the time of their disposal. The claimant, on the other hand, has stated in its application that the value of the shares in the company to be disposed of had fallen during the period in which the management of the company was transferred to the respondent as the purchaser of the shares, but that the respondent had undoubtedly expressed its acceptance of the transaction entered into by the parties throughout the duration of the Agreement.

The judgment of the Latgale Suburbs Court of Riga City partially upheld the claim, including by determining the value of the shares to be forfeited as EUR 700 000, and dismissed the remaining part of the claim regarding the determination of the value of the shares as EUR 205 340 and the recovery of this amount. The Riga Regional Court, after hearing the case on the defendant's appeal, dismissed the action in the appealed part, disagreeing to the first instance court conclusion that the parties had agreed on the share transfer fee in the Agreement as a preliminary agreement, arguing, that under the preliminary agreement liability for breach of the preliminary agreement may arise not for failure to deliver the file but for failure to conclude the agreement, and that liability may be expressed only in damages. According to the appellate instance court, the preliminary agreement does not confer the right to require the conclusion of the intended contract, since that would be contrary to the principle of the private autonomy of the parties.

The applicant lodged a cassation appeal against the judgment of the appellate instance court, appealing against it in its entirety, arguing that the court had failed to take into account the legal doctrine on the nature of the contract of prior performance expressed in several other sources of legal literature, relying solely on the subjective opinion of one author.

The Senate of the Supreme Court, having examined the case in cassation, concludes that the judgment of the Court of Appeal should be set aside and the case should be referred back to the Regional Court for a fresh hearing. The Senate notes that there is no dispute in the case that the Agreement should be recognised as a preliminary contract and emphasises that, as regards the assessment of the nature of a preliminary contract, where different opinions have been expressed in legal doctrine on the same point of law, the court must critically assess and weigh those opinions against each other, indicating which of them it agrees with and why.

As to the nature of the contract itself, the Senate, referring to Roman law and to Swiss and German legal doctrine, states that a contract is a genuine, binding contract by which one or both parties undertake, subject to certain conditions, to enter into another binding contract, including one with certain contents, and that it is therefore wrong to conclude that, in the case of a contract, there is no immediate intention on the part of the parties to be bound. Accordingly, the conclusion of a preliminary contract does not create an immediate obligation to perform the main contract to be concluded in the future, but it does create an obligation on the parties to conclude that main contract and, unless the parties have expressly reserved to themselves the right to further negotiate ancillary terms, the contract must be regarded as definitively concluded. Although a preliminary contract gives a party the right to claim damages in the event of its breach, it does not exclude the right to claim the conclusion of the main contract, unless that has become impossible, and such claims may be joined in a single action if the legal and factual circumstances of the case so permit, taking into account that it would not be procedurally economical to conduct two separate, successive proceedings.