CHAPTER 24

Opportunities of Use of Option Agreements in the Post-COVID Economy: Comparative Legal Study from Russian Law and English and American Law Prospective

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Introduction

Modern challenges are not just international, country-specific, regional factors of global crises, but also global factors and threats (such as COVID-19 pandemic) that affect all countries in one way or another, regardless of country differences as well as differences in the level and quality of life, socio-economic development and potential.

The COVID-19 pandemic is taking a substantial toll on a great number of economies and societies. At the pandemic's onset, governments worldwide imposed stringent measures to contain the spread of the new virus. These measures resulted in significant short-term economic disruption

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and job loss, compounded by falling confidence and tighter financial conditions. Emergency measures were put in place in many countries, including preservation of the incomes of companies during confinement relating to the COVID-19 pandemic. As the health and human toll grows, the economic damage is already evident and represents the largest economic shock the world has experienced in decades.

Despite the initial predictions of possible changes in the global architecture of the international capital movement, the state of the capital markets, changes in the investment attractiveness of countries and regions of the world (including the Russian Federation and the USA and the United Kingdom, being the world's major economies) under coronavirus pandemic conditions, on the agenda of many economic as well as legal studies is the research of the impact of harmonization of law in order to simplify entering into different business transactions.

Therefore, research on the process of forming investment attractiveness of the economy, especially in the context of post—COVID conditions, is an extremely relevant area for analysis of the opportunities of different legal systems and different legal mechanisms which may make doing business more simple and attractive (in particular, at the present stage).

The author conducted a review of research on option agreements regulation and different possibilities of use thereof in the context of post—COVID economy. This contractual construction is commonly used in international business transactions and allows to define the standard conditions included in the agreements and to determine common rules of contractual cooperation between the parties in the future.

An agreement on granting an option to conclude a contract is of great interest for the theory and practice of entrepreneurial interaction, which is explained by the deferred effect of the agreement that depends only on the will of one of the parties. It is substantiated that introduction of the institute of an option agreement in Russian legislation and entrepreneurial activity should have a positive effect on both the development of contractual business relationships and the participants and shareholders of different legal entities.

The assessment of the development level of the problem of legal regulation relating to the option agreements and investment attractiveness of economic systems in the face of global threats of both economic and non-economic nature (including coronavirus pandemic conditions) was also carried out.

Methodology

The methodology of the study comprises comparative, formal-legal, functional methods and systemic approaches. The results of the study of problematic issues of option agreements' regulation in the Russian Federation and in two leading common law states (the United Kingdom and in the United States of America) form the ground for creating a position on the opportunities to adopt their experience in the Russian Federation for forming investment attractiveness of the Russian economy (as well as ex-USSR countries' economies) and facilitating the development of the Russian civil law (as well as ex-USSR countries legal systems). The findings of this research can be applied for further developing models for legal regulation of option agreements in the Russian Federation and in ex-USSR countries as well as using positive aspects of the considered experience of common law legal systems in Russian legal system and in ex-USSR countries' legal systems.

Results

Influence of COVID-19 Pandemic

The COVID-19 lockdown being a strange and difficult time, and if you are looking to buy or sell some property at first glance it may seem that now might not be the best time to enter into a contract. However, it is a good time to consider an option agreement, particularly if you are buying or selling some assets at the moment (for example, some commercial real property assets for further development).

As COVID-19 is impacting on conveyancing transactions some parts of the market are inevitably slowing down at the moment, but many companies and persons are looking forward to making their investments (or a part thereof) when lockdown measures are lifted, so by putting an option in place now, it will give the ability for such companies and persons (including but not limited to the developers and landowners) to make the best of the situation in due course.

An option agreement offers flexibility as to timings, which is a key consideration at this post—COVID period of time taking into account a general volatile economic situation in the world. Frequently options are drafted to allow the offerees (being, as a rule, the purchasers under the relevant option agreements) to exercise their ability to purchase the shares or participation interests in charter capital of other companies or some other particular assets (a land or some other property under construction, for example) at any time during the option period. This allows the relevant offerees to choose the most appropriate time to exercise the option, permitting them to take account of matters such as the grant of necessary documents, licenses or permissions, availability of finance and the ability to make business, in general, following the cancellation of the stringent measures imposed by the governmental authorities in connection with the COVID-19 pandemic.

It's an open secret that every business transaction is a result of some social facts and of a long development of humanity (Osipov, 2020). As it was mentioned above, use of option agreements is necessary when structuring complex M&A deals (including when acquiring shares in charter capital of joint-stock companies and participation interests in charter capital of limited liability companies), joint ventures and venture capital transactions and other assets acquisition deals (for example, acquisition of some commercial real property).

Unlike when structuring derivative financial instruments (options, futures and forward transactions), option agreements have no speculative or hedging function but in some cases may have the similar economic effect. By applying option agreements, one party to a transaction may secure its legal rights and interests to buy or to sell some assets (including shares and participation interests) at its sole discretion depending on any fact, event, circumstance or omission. It is especially important to have such possibility in a situation of unpredictability, in general, and within current volatile post—COVID economic situation, in particular.

Russian Law Prospective

In view of current Russian civil law reform, including civil legislation, the problems connected with business transactions (including entering into option agreements) remain actual for different legal research works and studies.

It should be mentioned that before March, 2015 Russian law does not provide for the protestative conditions (the most frequently used in English and American law as conditions precedent or CPs), which mostly depends on the discretion of only one party to the transaction, and, therefore, that was one of the main reasons of unattractiveness of Russian law for foreign investors from the developed countries as well as absence of the relevant uniform and consistent Russian court practice.

In particular, before the amendments introduced legal concept of option agreements into the Civil Code of the Russian Federation, option agreements, entered into under Russian law, were at risk of being invalidated by Russian courts that would often hold them to be conditional transactions on the basis of a narrow interpretation of Articles 157 and 327 of the Civil Code (transactions concluded under a condition which shall not depend on the discretion of only one party to the transaction) (Online legal system Consultant Plus, 2021).

Even though the principle of freedom of contract is enshrined in the Russian Civil Code, Russian law and Russian courts have for many years taken a hostile or equivocal approach toward the inclusion in Russian contracts of many instruments often used in international business transactions (in particular, governed by English law).

That was one of the most common reasons why most Russian complex business transactions were governed by English or American law during the last few years. Nevertheless, in a great number of financial, investment and JV transactions such conditions precedent depending on the sole discretion of one party to the relevant transaction as well as option agreements are often used and highly requested for international business transactions.

As a consequence, the relevant Russian law was further changed by adopting the relevant concept of English and American law and its implementation in two new Articles 429.2 and 429.3 of the Civil Code of the Russian Federation (Online legal system Consultant Plus, 2021). On March 8, 2015 the President of Russia signed into law a new bundle of amendments to the relevant civil legislation (Online legal system Consultant Plus, 2015), which should resolve some of the above issues and make Russian law more user-friendly and flexible for Russian and foreign entrepereneurs. It should be mentioned that Russian law has adopted simultaneously two models of option regulation:

a. an agreement on granting an option to enter into a contract whose subject-matter is the provision of a right (by way of an irrevocable offer) to enter into one or more principal agreements (Article 429.2 of the Civil Code), for example, an option to enter into a lease agreement by way of which the lease agreement is entered into upon exercise of the option by the relevant rights-holder; and

b. an option agreement whose subject-matter is the right to require the performance of some actions or transfer of some property contemplated by such agreement (Article 429.3 of the Civil Code), for example, an option to buy or sell assets without execution of a separate sale and purchase agreement.

Moreover, new Article 327.1 of the Civil Code was introduced and now allows conditions within the control of only one party to the transaction. The performance of obligations as well as the exercise, variation and termination of certain rights or obligations under a contract may be made conditional upon a certain act being done or not done by one of the parties, or upon the occurrence of any other circumstances as provided for by the contract, and such actions or circumstances can be, in particular, within the control of only one of the parties to the relevant contract.

In comparison with other contracts, one of the main differences between a preliminary contract and an option to conclude a contract is that, according to general civil law provosions, a preliminary contract is a bilaterally binding contract, whilst the will of one party is required to conclude the main contract on the basis of an option to conclude a contract, therefore, such a party has some kind of transformation right (Karapetov, 2020; Ruzakova, 2018).

In essence, both types of contracts (option for execution of contract and option contract) have little difference: in both cases there is an authorized party, which unilaterally acquires the right to demand a liable party to perform a certain actions or transfer some assets. In both cases the contract may provide for an option fee for granting the option or in exchange for a consideration other than money (another cause or causa) or even may be granted without any consideration in some cases (if parties have not expressly agreed upon its gratuitousness), as opposed to English law which requires always some consideration (at least, nominal) to be paid by the grantee. Nevertheless, it is highly recommended to have some consideration or another causa when entering into option contracts governed by Russian law.

Figure 24.1 shows a general scheme of option contract formation and its exercise under Russian law as opposed to conditional contract formation and exercise.

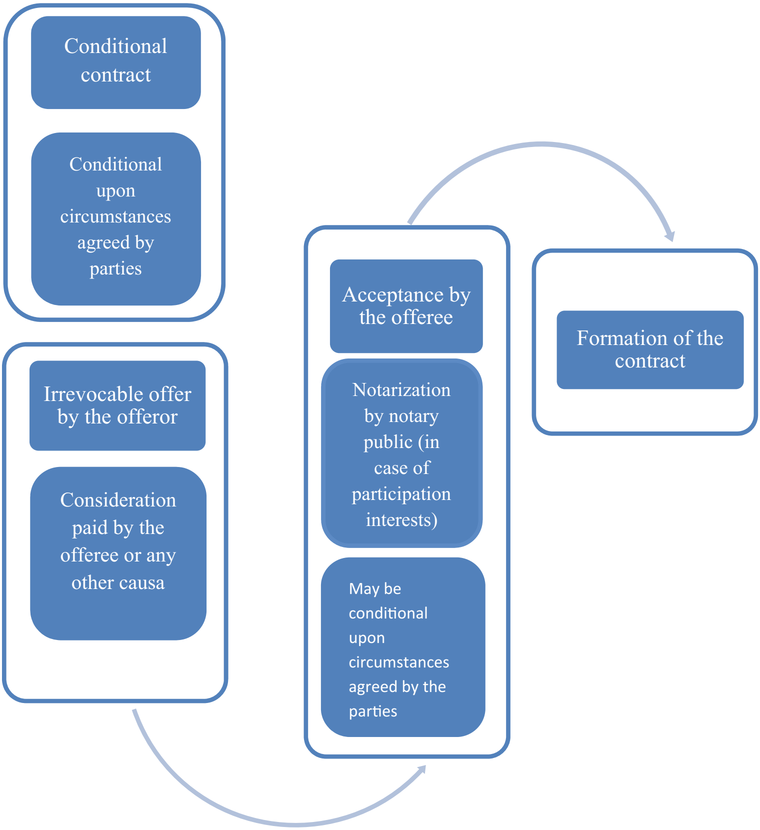

Fig. 24.1 General scheme of option formation and exercise under Russian law as opposed to conditional contracts formation and exercise (*Source* Created by author)

Common Law Prospective

Under common law, an option stands midway between an offer and an unconditional contract. It creates a unique relationship, with characteristics both of an irrevocable offer and a conditional contract. Put simply, an option is a right to execute or relinquish a transaction on fixed terms within a prescribed period of time. It is usually acquired by contract and when supported by consideration an option is binding on the grantor.

The person in whose favour it is made, the option holder, assumes no obligations (Dray et al., 2016).

An option must be distinguished from a conditional contract. The fundamental difference between them is that a conditional contract creates an obligation on the grantee to buy when the conditions are fulfilled, whereas an option gives the grantee a right but no obligation to buy. Whilst the vendor is clearly in a weaker position with the absence of the purchaser's commitment when entering into an option, this lack of mutuality of obligation at the outset usually comes at a price, and the purchaser is essentially buying the right to acquire some asset in the future.

An option has at least some of the characteristics of an offer in that it can become a contract of sale when the purchaser accepts it by exercising the option (Treitel, 2015). The grantee obtains an equitable interest in the property the subject of the relevant option, giving it equitable remedies and a priority over the later competing claims over the relevant asset.

Therefore, the option has often been characterized as an irrevocable offer to enter into the transaction which will be accepted and therefore form a contract for the transaction when the option is exercised by the grantee. Sometimes, however, the option is said to be already a conditional contract to enter into the transaction where the exercise of the option by the grantee converts the conditional contract into an unconditional contract (Helby v Matthews, 1895). In the context of land options, it has also been said that an option is a relationship *sui generis* which is neither simply an irrevocable offer nor a conditional contract but analogous to both (Spiro v Glencrown Properties Ltd, 1991).

At the same time, the contract of option must be distinguished from the following: (i) the option to accept or reject an offer; (ii) a contract subject to a condition precedent; (iii) a contract providing one party with the option of alternative performance; and (iv) a right to waive a provision wholly in one person's favour.

An option must be distinguished from a 'right of pre-emption' by which a landowner agrees to give the purchaser the right to buy 'at a figure to be agreed' should the landowner wish to sell (therefore, a right of pre-emption is not itself an offer but an undertaking to make an offer in certain specified future circumstances) (Tiffany Investments Ltd v Bircham & Co, Nominees, 1957).

The grant of a right of pre-emption entitles the grantee to become a preferred purchaser if and when the grantor decides to sell his asset (for example, a land). A right of this kind is sometimes termed a right of first refusal (ROFR) or right of first offer (ROFO), which is something of a misnomer since the grantee contracts for the opportunity to accept an offer rather than an opportunity to refuse one.

In comparison with the right of first refusal, the grantee does not have the sole right to determine whether to purchase the property or when—that rests with the grantor who is free to retain the relevant property indefinitely and has no obligation to sell it (opposite to the above construction of the option agreement). The grantor is, therefore, the one who determines whether a vendor/purchaser relationship (as the case may be) will arise. In a sense, unlike an option, the grantee's rights remain inchoate until the grantor triggers them (i.e. the grantor has in effect a negative obligation in that it cannot offer its property for sale, for example, without first offering it to the grantee) (Chuprunov, 2020; Farrands, 2010).

Therefore, an offeree may need time to decide whether to accept the offer and, during that time, may need to spend money and effort. The doctrine of consideration, combined with the rule of free irrevocability makes it impossible for the offeror to give the offeree the desired protection merely by saying so. The conventional way for the offeree to overcome the obstacles imposed by the common law rules and get the desired protection is by means of an option (Farnsworth, 2004). An option is itself a contract, sometimes called an option contract or an option agreement to distinguish it from the principal contract to be formed on acceptance the offer (Estate of Claussen, 1992). An irrevocable offer is commonly called an option and, like any other offer, an option imposes no duty on the offeree which has unfettered to either accept the offer or not (Syrovy v. Alpine Resourses, 1993).

A contract of option is one whereby the grantor of the option offers to enter into what may be called a 'major' contract with a second person and makes a separate contract to keep his offer open. Usually, the person to whom the grantor of the option binds himself to keep the offer open is that second person, who may be conveniently referred to as the 'option-holder' (Halsbury's Laws of England, 2019).

The offeror can make an option if the promise not to revoke is supported by consideration. A promise not to revoke an offer may also be supported by consideration other than money. Thus, an option may be part of a larger transaction as, for example, when an option to renew a lease or to purchase the premises is given to the lessee as part of the lease.

Figure 24.2 shows a general scheme of option contract formation and its exercise under English and American law (Source: author).

In terms of classification, the contract of option may be unilateral or bilateral. It may exist either as a separate option contract, or as part of a larger contract such as one of the following: a lease with an option in the lessee (of land) to renew the lease or buy the reversion, as the case may be.

If the option falls on an agreement for the transfer of some real property, as is the case of the purchase option, it can also be constituted as a right *in rem*. This reinforces the effectiveness of the right, and grants not only its direct exercise against third parties, but also the immediate acquisition of ownership of the good (Capdevila, 2021). An option (or

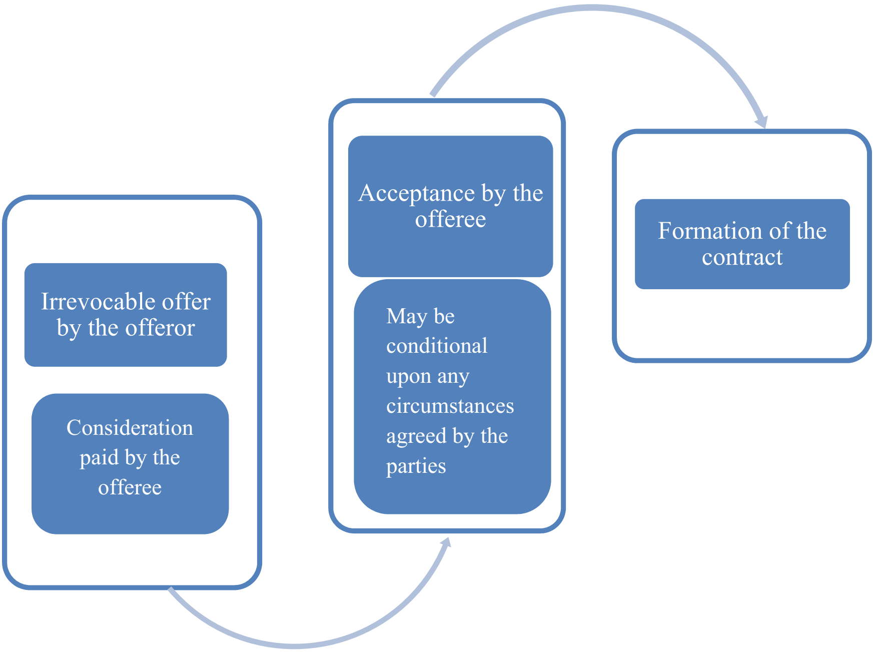

Fig. 24.2 General scheme of option formation and exercise under English law (*Source* Created by author)

covenant) to renew a lease entitles the tenant to call for a further lease or underlease of the demised premises on the expiration of the existing term, subject to his complying with the provisions of the option. Like an option to purchase, it restricts the grantor (the landlord) and gives a right to the grantee (the tenant) which he is not bound to exercise. On exercise the parties are brought into a new legal relationship (United Scientific Holdings Ltd v Burnley BC, 1978). Alternatively, an option may also be conferred on a tenant to buy the freehold reversion. An option contained in a lease differs from a standard option agreement because the grantor and the option holder stand in the relationship of landlord and tenant, and that the contract creating it is made part of the terms on which the lease is granted (Griffith v Pelton, 1958).

Opportunities of Use of Option Agreements in Different Business Transactions in Post-COVID-19 Economy

Options are entered into for all sorts of reasons—for example to gain some tax advantage, in settlement of a dispute or in the making of some family arrangement, for example. Economics, however, explains why many options are granted.

Put and call options are used on joint ventures, M&A deals and financing structures (particularly where offshore holding companies are involved) (Glukhov, 2019). They can be used:

a. to provide an exit strategy for one or more of the parties or partners to the relevant M&A or JV transaction; and
b. as an enforcement mechanism on default under a shareholders' agreements (SHA) (Thomson Reuters. Practical law, 2011) including resolution of different corporate conflicts (the number of which has significantly increased, since the current COVID-19 pandemic has not only had an immense impact on our social life and health but on the global economy and corporations as well) and deadlocks by means of such mechanisms as '*Russian roulette*' and '*Texas shoot-out*' (particularly where there are concerns about trying to enforce directly against assets in Russia). A common feature of JVs in the Russian market is the inclusion in SHAs of provisions which allow for the exit of a JV partner through the use of a put option (whereby one JV partner can require the other to purchase his shares) or a call option (pursuant to which one JV partner can

require the other partner to transfer his shares or participation interests in charter capital of such JV to him). Exit triggers should take into account significant project risks, such as new restrictive measures which may be imposed in connection with new coronavirus pandemic conditions. In case of a call option, the holder can decide when to invest. He preserves more of his capital and makes his decision on when to buy (if at all) when economic conditions are thought to be more favourable to him. He cannot eliminate risk by using an option, but he can reduce it (Dray et al., 2016). The call option allows to reserve the right to buy an entity's participation interests or shares. Call option agreement guarantees the entry into a sale and purchase agreement by a court in case the seller avoids voluntary execution of such contract.

If we talk about usual business transactions in relation to the shares or participation interests in companies' charter capital, then entrepreneurs also use call or put option agreements. A put option is a right of an owner to sell to a specified person. Like a call option, the sale can be at a fixed price or at a price based upon valuation and the option holder (the vendor) is not bound to exercise such option. An enforceable call option (or option to purchase some assets) confers on the grantee a right to call for a transfer of the relevant shares or participation interests from the grantor provided that the grantee complies with all the terms and conditions of the option agreement.

At its most basic, the put option is a marked example of spreading if not eliminating risk. In fact, the put option can be seen as a form of some kind of insurance against risk. For instance, a person might buy some real property coupled with a put option at a fixed price. If the land value rises, then the landowner continues to hold it. If the land value falls, the landowner can exercise the put option and pocket the exercise price (Brealey & Myers, 1988).

Under common law, options, rights of first refusal and certain other pre-emptive rights have commonality in that they all prescribe circumstances in which the grantor and grantee of the right may become vendor and purchaser, respectively.

Therefore, the option contract allows one of the parties to claim the conclusion of a projected contract, whose essential elements (including, as a rule, a price) are already determined, or to give effect to this same contract by making the reciprocal benefits enforceable. The option binds the grantor contractually in favour of the grantee according to the terms and conditions of the option which he has granted, but it does not impose any obligation on the grantee who has a unilateral choice whether to exercise the option and thus to enter into the relevant transaction.

Such possibility seems to be exceptionally pertinent nowadays in post—COVID economy due to the fact that a party may be unwilling to purchase the full control (100% of shares or participation interests in charter capital of some company, for example) at the relevant moment.

It is also possible for the parties to grant cross-options in relation to the same transaction, each party having the right (as grantee) to require the other (as grantor) to enter into the relevant transaction, but the requirements for a valid option must be satisfied in relation to each one of such cross-options.

In terms of a land or some other real property sale and purchase transaction, an option agreement is an agreement entered into by the owner of the relevant real property (or by a person/entity which is obliged to build some real property in the future) and a potential purchaser (a developer, for example) of the owner's real property. This form of contract may provide a balance of security to both real properties' owners looking to sell and developers who would like an interest in the land prior to outlaying costs in applying for its planning or prior to cancellation restrictive measures imposed in connection with the COVID-19 pandemic.

When the parties enter into the agreement, often an agreed payment is made to such owner and in exchange, the purchaser is granted a contractually binding first option to purchase the relevant real property. The purchase must take place within the option period (which can potentially last several years) or as a result of a trigger event, such as planning permission or a certificate of acceptance, for example, being granted to the relevant person (Legislation.gov.uk, 2021).

Therefore, the option agreement prevents the owner of real property from selling the property whilst the developer is exploring the viability of the project or obtaining some permits thereby reducing the risk and potential cost to the developer. The relevant real property is not purchased until it is exercised by the purchaser, which can be predicated by some trigger event.

The real properties' owners have the benefit of knowing that during the option period they may benefit from the relevant developer (being an offeree under the relevant option agreement) exercising the option and paying an option premium for the relevant real property (right thereto), whilst such a developer has the ability to obtain planning or permits, without the risk that they will be compelled to acquire a parcel of land without the benefit of planning (Richards, 2021).

A developer may also be able to fix the purchase price (or price determination method) with the landowner at the outset of the option agreement and that may prevent the purchaser from incurring any unanticipated costs or any price increase in the future. This means that there is certainty of initial costs and the developer may potentially end up paying less than actual market value.

Of course, on the one hand, an option agreement does not guarantee a sale. On entering into an option agreement, the owner of the relevant real property often needs to grant a standard security to the developer which means the seller cannot sell the land, for example, to a third party for the period of time agreed in the option without restriction. On the other hand, the offeree gives the offeror some kind of consideration in exchange for keeping by the offeror such an offer open for a certain period of time.

Remedies for Breach of an Option Contract

As for the remedies for breach of an option contract by the grantor, if the grantor causes the grantee not to obtain that transaction (for example, by refusing to accept and act upon a valid exercise of the option, or by entering into a competing transaction with any third party which makes performance impossible in favour of the grantee of the option), the grantor is in breach of the option contract and the grantee is entitled to the following usual contractual remedies for breach:

a. the grantee will be entitled to damages: on normal contractual principles this will cover the loss the grantee suffers by not obtaining the transaction, including the profits he would have made from it (Cartwright, 2019); and
b. in a case where the transaction is still possible, and where damages are an inadequate remedy, the court may order specific performance of the option contract, and therefore require the grantor to enter into the relevant transaction (this remedy is most commonly awarded in the case of options to purchase real property, but may also be available in another case where damages are inadequate, such

as a contract to purchase shares in a private company for which there is no ready market) (Pena v Dale, 2003).

It is also vital for the grantee to consider whether the burden of the option should be registered against the grantor's registered title. If it is not so registered (and unless the grantee is protected in registered land by being in actual occupation of the grantor's land) it will not be enforceable against a purchaser for value of the grantor's estate, and the grantee's remedies will be limited to damages against the grantor personally (Cartwright, 2019).

Discussion

Research on the development of legal regulation in respect of option agreements in different countries and on different possibilities of use of option mechanisms are provided for in the works of domestic researchers, such as E. Glukhov (2019), I. Chuprunov (2020), A. Karapetov (2020), and V. Ralko et al.(2019).

Studies of English and American law aspects relating to option agreements are marked in the works of such researchers as Donald J. Farrands (2010), Richard Brooks and Waldron Blake Dawson (2021), Arthur Corbin (1914), E. A. Farnsworth (2004), and M. I. Inozemtsev (2021).

Conclusions

The analysis of advantages of use of option agreements in a post-COVID-19 economy has allowed to identify the key competitive advantages of this legal mechanism which allow the entrepreneurs to exercise their ability to purchase or to sell the relevant assets at any time during the option period taking into account the current economic and financial uncertainty and the financial market volatility.

In general, the obtained research results are necessary and in demand in terms of finding and implementing other competitive advantages of the considered countries legal regulation, doctrine and the relevant court practice relating to the option contracts that will work in the new difficult economic conditions taking into account the current COVID-19 pandemic.

The option can be very useful during negotiations for a contract where one party is not yet in a position to enter into the contract but wishes to be sure that it has the right to enter into a contract which provides for a fixed price. It can also be very useful to ensure that a present contract may be followed by a future contract (e.g. the renewal of a lease) if one party so wishes it when the time comes (after coronavirus pandemic conditions and/or all of the restrictive measures imposed by the relevant authorities are cancelled).

However, an option must be carefully drafted to ensure that it does not fail for uncertainty. This means that an option is useful and effective only where the terms of the principal transaction have already been settled (e.g. the price to be fixed by reference to objectively determinable market conditions when the option comes to be exercised).

As for the actions for entrepreneurs to take now, then they shall:

a .consider whether COVID-19-related events and circumstances have triggered a requirement to reassess renewal, termination or purchase options, and

b .consider the impact of any changes in economic incentives on whether a company is reasonably certain to exercise, or not to exercise, such options.

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