



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
INSTITUT INTERNATIONALE POUR L'UNIFICATION DU DROIT PRIVE

**Working Group for the preparation of
Principles of International Commercial Contracts (3rd)
Fourth session
Rome, 25 – 29 May 2009**

UNIDROIT 2009
Study L – Doc. 113
English only
April 2009

Draft Chapter
on
Conditional Obligations

Revised draft rules with Comments prepared Professor Bénédicte Fauvarque-Cosson
in the light of the discussions of the Working Group at its third session held in Rome,
26-29 May 2008

Introduction to the Draft

This is a draft of the future chapter of the Unidroit Principles on "Conditional obligations".

The proposals take into account the discussions which took place at the Rome meetings in 2006, 2007 and 2008. They have considered the solutions given by some significant earlier models, giving special attention to the corresponding provision of PECL and the OHADA draft on contracts. References have been added to other models, particularly to the provision on conditional rights and obligations of the Draft Common frame of Reference (III.-I:106).

Earlier discussions are to be found in the Summary Records of the two Rome meetings ("SL Misc. 26", SL Misc. 27" and "SL Misc. 28") and in the rapporteur's Position papers for the 2007 and 2008 meetings.

This document has been prepared for the Rome meeting of May 25-29, 2009. For the first time, Comments are submitted.

Article 1
Types of Condition

A contractual obligation may be made conditional upon the occurrence of an uncertain future event, so that the obligation takes effect only if the event occurs (suspensive condition) or comes to an end if the event occurs (resolutive condition).

COMMENT

1. Scope of this chapter

By virtue of the autonomy principle, contracting parties can make their contract (or the contractual rights and obligations which derive from the contract), conditional on the occurrence or non-occurrence of an uncertain future event. A right or obligation is conditional if it depends on the occurrence or non occurrence of future and uncertain events.

This chapter only deals with conditional obligations which are of a contractual origin. This is expressed by the wording of article 1 : the expression "may be made conditional" implies that the condition is of contractual origin.

Consequently, this chapter does not deal with what is sometimes referred to as "condition imposed by law" but ultimately is a requirement imposed by law. Most practical aspects of public permission requirements are already covered by PICC, Art. 6.1.14 et seq. When a public requirement imposed by law and not expressly stated in the contract is not complied with, the party who was due to comply with it is in breach of contract. When a public requirement imposed by law is stated as a condition in the contract, the rules on this chapter apply. When compliance with a country's law which is not the law applicable to the contract is agreed upon by the parties, this condition is of a contractual origin.

2. Notion of condition

Condition is a broad term which has different meanings. In particular, it is often used to refer to the main elements of the contract (the conditions of the contract). In this Chapter, the word condition is used in respect to a right or obligation which is made conditional by the parties.

A condition is distinct from what in civil law countries is called a "term" and designates a future but certain event.

The fact that the condition incorporates a time of performance does not change the nature of the conditional obligation. Time of performance is dealt with in article 6.1.1. It may be a specific date or an event that is bound to happen

Illustrations

1. The contract will be concluded provided that all necessary authorisations are given before January 30. The obligation is conditional (suspensive condition) and the condition incorporates a time of performance.

2. A contract of sale is concluded on January 2, with delivery of goods to be made to buyer by the seller on January 30. The obligation to deliver is future but certain. It is not conditional since January 30 will definitely arrive.

3. A is bound to pay C *when* B dies. It is a time of performance and not a condition since it is certain that B will die.

If the condition does not state a time of performance, a time of performance may be implied, as a result of interpreting the parties' intention according to the Unidroit Principles' general provisions on interpretation. Besides, Art. 6.1.16 on « Permissions neither granted nor refused » gives a party the right to terminate the contract when permission is neither granted nor refused « within a reasonable time from the conclusion of the contract ».

Illustration

4. A party undertakes to repurchase a certain amount of stocks from a corporation if the net profit reaches a certain level. The obligation is conditional (suspensive condition) and does not incorporate a time of performance

Sometimes, contracts expressly provide that the performance by one party is conditional upon the performance of the other party. Such provisions are not "conditions" (even if in practice they are often called "promissory condition" or "condition precedent") but a mere way of further defining both the precise content of each party's obligation and the time the performance is due. If the party who is due to perform first does not perform, this is a normal case of breach of contract.

Illustration

5. In a share capital increase, the clause entitled "Condition precedent" states that the obligation of the lead managers at the closing date to subscribe for the shares is subject to the realization of several conditions among which the following, named "performance of undertakings", which so provides: "the issuer has performed all of its obligations hereunder to be performed on or before the closing date".

3. Suspensive and resolute condition

There is a suspensive condition when a contractual obligation is made conditional upon the occurrence of an uncertain future event, so that the obligation takes effect only if the event occurs. In practice, the suspensive condition is often named "condition precedent".

Illustration

1. The contract is concluded under the suspensive condition of receipt of all necessary antitrust clearance for the transaction from the European Commission and any other competition authorities having jurisdiction over the parties or the transaction whose clearance, if not obtained, would prohibit completion and notification of the transaction having been made to the national authorities in X country

There is a resolute condition when a contractual obligation is made conditional upon the occurrence of an uncertain future event and it comes to an end if the event occurs. In practice, the resolute condition is often named "condition subsequent".

Illustrations

2. A leasing contract is made subject to the condition that payment is made at the end of each month during 2 years. After 12 months, payment is no longer made. The contract comes to an end.

3. A contract for the assignment of all rights, interest and title as well as the obligation of the assignor under the receivable is made under the resolute condition that the assignment of the receivable, to the extent only of the amount of the Capital reduction, shall be subject to the condition subsequent of:

- a) the assignor receiving a demand for security from one or more creditors within 2 months from the date of the capital reduction in accordance with the commercial code
- b) the assignor not being able to satisfy such demand.

A clear distinction is not always made between a suspensive and a resolutive condition. In practice, matters can be complicated and interpretation of the parties' intention is then needed, considering their reciprocal interests.

In the absence of a contractual provision, the right to renounce to the benefit of a suspensive condition will be governed by the following general principles : such a right can be exercised by the party for whose exclusive benefit the condition has been stipulated, as long as the condition has not been satisfied and provided it does not violate the other party's legitimate expectations (art. 1.8).

4. Impossible condition

A condition must be possible. This results from the concept of condition. If, from the very beginning, the condition is impossible (initial impossibility), there is no state of pendency and hence no obligation, neither conditional nor unconditional. The rules on mistake may, in some cases apply. If impossibility is supervening, a valid conditional contract is concluded but it comes to an end when the supervening impossibility occurs.

Illustrations

1. A payment under the contract is subject to the issuance of a bank guarantee by a financial institution that has been liquidated the day before the contract is signed. This is a case of initial impossibility.
2. The parties agree that the sale is conditional upon an export licence being granted to the seller. The parties do not know that such a licence cannot be granted because the government has already imposed an embargo. The rules on mistake may then come into play and the contract will be invalid. When appropriate due to the circumstances of the case, the rules on restitution following avoidance will then apply.
3. The parties agree that the sale is conditional upon an export licence being granted to the seller. An embargo is imposed after conclusion of the contract but before the export licence could be obtained. If appropriate due to the circumstances of the case, the rules on restitution following termination will apply.

The rules on illegality apply to conditions.

5. Condition entirely dependent on the will of a party

A "condition" can be phrased in such a way that it clearly indicates that a party does not want to be bound. In such a case, there is no obligation at all, not even conditional.

Illustration

1. A will sell the machinery to B if A so wishes.

In other cases, such as sales upon approval, a party – the buyer- has some discretionary power and yet intended to be bound.

Illustration

2. B will buy the machinery if, after one month, B is of the opinion that it meets its needs.

In some commercial contracts, the list of "conditions precedent" may include some "conditions" which explicitly or implicitly depend on the "satisfaction or discretion" of a party. The explanation for this is that most of the time, there is no contract yet. Parties still are at a precontractual stage.

Illustration

3. In an international share purchase agreement, parties agree that completion of the transaction is conditional on the approval of the transaction by the supervisory board of the seller.

6. "Closing"

Parties to complex and high-value business transactions that involve prolonged negotiations frequently provide for a so-called "closing" procedure, i.e. the formal acknowledgement ("closing") at a certain point of time ("closing date") that on or before that date all the stipulated conditions ("conditions precedent") have been satisfied. Normally, but not necessarily, on the "closing date" the parties will sign a document which confirms that no "condition precedent" survives or, if some conditions have not been satisfied, they have been waived.

Despite the terminology used by the parties, not all the events referred to as "conditions precedent" are "conditions" as defined by the present Article. Thus, for instance, while events such as the receipt of all necessary antitrust clearance, the admittance to trading on a stock exchange, the granting of an export licence, the obtaining of a bank loan, etc., may be actually intended as true suspensive conditions, others such as the accuracy of one party's representations or warranties, the commitment to perform or abstain from some specific acts, the submission of a tax certificate evidencing that no taxes are due by the party concerned, etc., are in fact obligations that the parties have agreed to fulfil before the formal conclusion ("completion") of the transaction.

Also with respect to the effects of "closing" there is no clear cut rule in practice.

In most cases the parties do not intend to be bound by the contract before the "closing date" and it is only on "closing" that the contract comes formally into existence. Circumstances that may suggest that such was the intent of the parties include, for example, listing as "conditions precedent" events that are not actually conditions in the sense given in this article, but real obligations that the parties must fulfill in the course of the negotiations, and/or allowing the party that benefits from the stipulation of the "conditions precedent" to withdraw from the deal by releasing that party from its central obligation under the contract they negotiated.

Illustration

1. A Share Capital Increase Agreement negotiated between Issuer A and Lead Managers B, C and D under the heading "Conditions precedent" provides as follows: "The obligation of the Lead Managers at the closing date to subscribe for the shares is subject to the realization of the following conditions precedent on or prior to the closing date, which may be (entirely or partially) waived by the Managers in their sole discretion:

- a. Accuracy or representations and warranties: each of the representations and warranties of the Issuer delivered in accordance to Section X is correct at the Closing date, as though they will have been given or made at such time;
- b. Performance of undertakings: the Issuer has performed all of its obligations hereunder to be performed on or before the closing date;
- c. Admittance to trading on stock exchange: the offer shares shall have been admitted to trading on the stock exchange;
- d. Delivery of any and all closing documents: the Lead Managers shall have received the following documents on or before the closing date: (i) authorization letter from the Issuer irrevocably authorizing the bank to deduct the funds in the blocked account immediately after execution of the

deed recording the realization of the capital increase, an amount equal to compensation, costs, expenses and other amounts payable by the Issuer to the Lead Managers under this Agreement and instructing it to pay the same to the Lead Managers [...]; (ii) lock-up letter: a lock-up letter by or on behalf of X; (iii) Opinion: an opinion letter from legal counsel of the Issuer, dated the closing date, in form and substance satisfactory to the Lead Managers; [...].

If any of the above conditions shall not have been satisfied at the time they should have been satisfied pursuant to this section, the obligations of the Lead Managers may be terminated by the Lead Managers."

On the other hand, the fact that the "conditions precedent" relate to events or situations outside the control of the parties or to acts by a third party may be seen as an indication that a binding contract already exists before "closing" but the parties intended it to be subject to one or more true suspensive conditions.

Illustration

2. An International Share Purchase Agreement entered into between Seller A and Purchaser B under the heading "Conditions Precedent" provides as follows: "Completion of the transaction is conditional on (a) the approval of the transaction by the supervisory board of the holding company of A; (b) the receipt of all necessary antitrust clearance for the transaction from the European Commission and any other competition authorities having jurisdiction over the parties [...]."

In any case the intent of the parties must be looked at carefully. Indeed irrespective of whether the parties intend to be bound by their contract only on "closing" or whether a binding contract already exists before "closing", the parties may assume a certain number of binding obligations that are instrumental for preserving the basis of their agreement and the object of the contract until "closing". See also Comment to Article 4 of this Chapter.

Illustration

3. A Share Purchase Agreement entered into between Seller A and Purchaser B provides that the transaction will be completed only if at the Closing date all the Conditions precedent, including B's obtaining from its banks the necessary credit, but as from the time of signature of the Agreement A is bound to restrict the company's activity to ordinary business management and B is under a duty of confidentiality as far as any information concerning the company it has received in the course of negotiations.

In order to avoid uncertainties concerning the effects of the envisaged "closing" procedure parties are advised to define them in as precise a manner as possible in their agreement. Thus parties wishing to be bound by the contract only on "closing" should expressly state that one of the "conditions precedent" to be satisfied at the closing date is "closing" itself, which they may describe as "the finalisation and signature of the Agreement containing all terms and conditions which are mutually acceptable including the acknowledgment that all the other Conditions precedent are satisfied". See also Article 2.1.13 and Comment 2.

Article 2
No Retroactive Effect

Upon fulfillment of a suspensive condition, the relevant obligation takes effect unless the parties otherwise agree.

Upon fulfillment of a resolutive condition, the relevant obligation comes to an end unless the parties otherwise agree.

COMMENT

1. A general default rule

Under these Principles, the fulfilment of a condition has no retroactive effect.

The main purpose of the provision is to provide a general default rule for situations in which the parties have not provided otherwise. If parties wish to depart from this rule, they should do so in a clear manner. Parties should be encouraged to give specifications as to the retroactivity or no retroactivity of the condition.

2. Non retroactivity

The effects of non retroactivity are the following :

When the suspensive condition occurs (or the last one if there are several), the contract automatically becomes effective from the moment the condition occurred. The suspensive condition suspends an obligation, several obligations or the whole contract.

Illustration

1. An international share purchase agreement is concluded subject to the suspensive condition of receipt of all necessary antitrust clearance for the transaction from the European Commission and any other competition authorities having jurisdiction over the parties or the transaction whose clearance, if not obtained, would prohibit completion and notification of the transaction having been made to the national authorities. On receiving all necessary antitrust clearance or other authorisations, the contract becomes effective.

When the resolutive condition occurs, the conditional contract comes to an end (if it does not occur, the contract remains fully effective).

Illustration

2. A factory under renovation has to lease replacement premises for the period of the renovation. A three year lease contract is concluded but this contract is to come to an end if renovation is finished before the end of three year period. The contract comes to an end.

Difficulties linked to the process of unwinding the contract may arise, particularly when the parties have agreed that a resolutive condition shall have retroactive effect, that is to say that the parties should be put in the same situation as if the contract had never existed.

Illustration

3. A factory is sold under the resolutive condition that no preexisting pollution of the soil will be detected in the future. A preexisting pollution is detected. If the resolutive condition has retroactive effect, seller is considered as having always been the owner of the factory and buyer as never having been the owner.

3. Anticipatory non performance of a suspensive condition and remedies

In the case of a suspensive condition, specific performance may not be required before the condition occurs. However, anticipatory non-performance is still available and, provided all conditions are met, the party who is to receive performance may terminate the contract according to PICC 7.3.3.

Illustration

1. An international share purchase agreement is concluded subject to the suspensive condition of receipt of all necessary antitrust clearance for the transaction from the European Commission. Before clearance is received, it becomes certain that the purchaser, which has severe financial difficulties, will not be in a position to buy the shares; in such a situation, seller can terminate the contract under article 7.3.

In the case of a resolutive condition, all the remedies available under a valid contract are available up to the moment the resolutive condition occurs.

Illustration

2. A factory under renovation leases replacement premises for the period of the renovation. A three year lease contract is concluded but this contract is to come to an end if renovation is finished before the end of three year period. The factory does not pay the lease. Lessor is entitled to terminate the contract for breach of contract (art. 7.3.1).

Article 3

Interference with Conditions

(1) If fulfillment of a condition is prevented by a party, contrary to the duties of good faith and fair dealing or co-operation, that party may not rely on the non-fulfillment of the condition.

(2) If fulfillment of a condition is brought about by a party, contrary to the duties of good faith and fair dealing or co-operation, that party may not rely on the fulfillment of the condition.

COMMENT

1. No interference with conditions

This rule on interference with conditions is a specific application of the general principle of good faith and fair dealing (art. 1.7) and inconsistent behaviour (article 1.8).

In commercial practice, parties may themselves expressly state such a principle of good faith as regard all the events upon which completion of the transaction is conditional. They may even go further and impose a duty to use "their best efforts to cause the conditions to be satisfied as soon as practicable ». Such clauses may also be imposed on one party only.

Under this rule on interference, the party is not under a duty to use all reasonable efforts to cause the conditions to be satisfied. This rule merely states that the party who, in bad faith, prevents the condition to occur may not rely on the non-fulfillment of

the condition ; if, on the contrary, it brings about the fulfillment of a condition, it may not rely on the fulfillment of the condition.

A duty of best efforts in one's activity is stated by article 5.1.4 Unidroit Principles (in practice, the reference to one's best efforts is more stringent than a mere reference to « reasonable efforts »).

2. Remedies

The available remedies (right to performance/damages) are to be determined in accordance with the contractual provisions and, in the absence of such clauses, with the general rules on remedies as well as with the particular circumstances of the case.

Illustrations

1. The licensing of a software package by B to A is agreed by the parties to be dependent upon the professional approval of the package by an independent computer engineer, C who is nominated by A. A then regrets the bargain and bribes C to disapprove the software package. A "may not rely on the non-fulfilment of the condition". B has a choice between performance (A is bound to perform the licensing agreement) or walking out of the contract with damages.

2. The licensing of a software package by B to A is agreed by the parties to be dependent upon the professional approval of the package by an independent computer engineer, C who is nominated by A. A fears that C will not give his approval and bribes C who approves the package. In spite of C's approval, A would not be entitled under the contract. B would then be under no obligation to perform, but he may perform if he chooses.

3. Under a joint venture agreement, a party is bound only if it obtains a building permit from the local authorities. This party deliberately omits to submit all the relevant documents in order to obtain this permit in due time. Fulfilment of the condition is prevented by this party and consequently, permit is not obtained from the authorities. The party who did not take the necessary steps for permit to be delivered "may not rely on the non-fulfilment of the condition". Concretely, this means that if delay has expired, the innocent party may claim for remedies. Indeed, since the condition is not fulfilled, it is not possible to treat it as if it was fulfilled and therefore, there can be no performance of the contract. On the contrary, if permit can still be obtained, the innocent party may force the other to take the necessary steps to obtain the building permit and ask for damages. It may also decide to walk out of the contract and ask for damages.

4. A construction contract is to be completed upon acceptance of the construction work. Acceptance is to be made on favourable advice of an engineer. The purchaser gives wrong information to the engineer so that engineer produces a negative report. In that situation, it is possible to treat as if the condition was fulfilled and to order a new expertise, based on proper information. Right to performance of the contract can then be ordered, provided it meets the requirements of article 7.2.2.

5. In a share purchase agreement (management buy out), a contractual clause provides that "if the conditions are not fulfilled before December 2009, seller may either seek specific performance or terminate this agreement. In the later case, no party shall have any claim against the other party as a result of such termination". This clause is valid provided that the contract is not unlawful due to the fact that a necessary condition (such as an authorization) is not fulfilled.

6. A seller –contrary to the duties of good faith and fair dealing – fails to obtain an export licence. Consequently, the goods may not be exported. The buyer can only claim damages, since performance would be unlawful and hence excluded.

Article 4¹
Rights Preserved

Pending fulfillment of the condition, a party may not act contrarily to the duties of good faith and fair dealing so as to prejudice the other party's rights in case of fulfillment of the condition.

COMMENT

This rule relates to the acts accomplished during the period which precedes the moment the condition is fulfilled (*"pendente conditione"*).

A person who benefits from a condition has a conditional right which deserves specific protection. During this period of time, a party's actions may detrimentally affect the other party's position. The underlying idea of the provision is that it is generally better to prevent such actions than to cure their results.

The situation *pendente conditione* is different from breach of contract in general and therefore deserves special treatment despite the fact that there is a general rule on good faith (art. 1.7).

The provision is also important as a reminder to the parties who enter into a contract under a condition to consider this issue and even expressly state which measures the person who benefits from the condition may take in order to preserve his/her rights. In commercial practice, particularly in « *contrats d'acquisition d'entreprises* », the parties draft a specific provision (named covenants) of ordinary course of business " (covenant) which produces effect between the date of signature and the closing date and which imposes on seller to do ordinary acts of « *gestion* » only. For other acts, both parties must reach an agreement.

This rule does not relate to proprietary rights. This question has deliberately been omitted throughout the Principles and cannot therefore be dealt with in a chapter on condition.

Article 5
Restitution in case of fulfillment of a resolutive condition in Contracts to be performed at one time

(1) On fulfillment of a resolutive condition contained in a contract to be performed at one time, either party may claim restitution of whatever it has supplied under the contract, provided that such party concurrently makes restitution of whatever it has received under the contract.

(2) If restitution in kind is not possible or appropriate, an allowance has to be made in money whenever reasonable.

(3) The recipient of the performance does not have to make an allowance in money if the impossibility to make restitution in kind is attributable to the other party.

(4) Compensation may be claimed for the reasonable expenses linked to the performance received.

¹ Note of the rapporteur : there was not a strong consensus in the group in favour of such a rule. Therefore, the rule could be deleted and the rule and comment below could be inserted as the last comment under article 1.

Possible Illustrations if the blackletter rule is maintained :
-share and purchase agreement : no to do or omit to do
- leasing

Article 6

Restitution in case of fulfillment of a resolutive condition in contracts to be performed over a period of time

On fulfillment of a resolutive condition contained in a contract to be performed over a period of time, restitution can only be claimed for the period after termination has taken effect, provided the contract is divisible.

COMMENT

Articles 5 and 6 only apply to resolutive condition.

When a contract comes to an end because of the fulfilment of a resolutive condition, there has been performance of reciprocal obligations, fully or in part. The question whether either party is bound to return or pay the value of whatever has been received from the other arises.

Difficulties may arise, which are linked to the process of unwinding the contract. Such difficulties will be even greater when the parties have agreed that a resolutive condition shall have retroactive effect.

In case of a suspensive condition, it may happen that a person has paid or transferred something before the suspensive condition is fulfilled. If, finally, the condition is not fulfilled, this advanced payment or transfer will lead to the application of rules on unjustified enrichment.