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**Draft Chapter  
on  
Conditions**

by

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## **Introduction to the Draft**

This is a draft of the future chapter of the Unidroit Principles on “Conditions”.

The proposals take into account the discussions which took place at the Rome meetings in 2006, 2007, 2008 and 2009.

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**Article 1**  
*(Types of conditions)*

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

COMMENT

**1. Scope of this section**

Parties to a contract may make their contract or one or several obligations arising under it dependent on the occurrence or non-occurrence of a future uncertain event. A provision to this effect is termed a condition.

A condition may refer to a range of events including natural events or acts of a third party.

This section only deals with conditions which are of a contractual origin.

Conditions imposed by law are not covered by this section unless they are incorporated by the parties into the contract. Thus a public permission requirement imposed by law is outside the scope of this section but may be governed by Art. 6.1.14. However, if parties introduce a provision into their contract making the contract, or their contractual obligations arising under it, dependent upon a public permission being granted, then that provision is a condition.

**2. Notion of condition**

The word “condition” may have a number of meanings. For instance, in some jurisdictions, condition means a major term of the contract. That is not the sense in which the term “condition” is used in this section.

Some contracts may provide that the performance by one party is dependent upon the performance of the other party. These provisions are not “conditions”, but obligations which the other party is required to perform. Accordingly performance is not an uncertain event for the purpose of this Article.

**Illustration**

1. In a share capital increase, the obligation of the lead managers at the closing date to subscribe for the shares is subject to a warranty that “the issuer has performed all of its obligations hereunder to be performed on or before the closing date”. Such performance is not a condition but a contractual obligation and as such it is not an uncertain event.

The parties may also fix a specific date at which the contract or one or several of the obligations arising under it is to take effect or is to come to an end. In many jurisdictions these provisions are referred to as “terms”. These are not conditions under this section. The same holds true when the parties include in their contract a provision

that makes the contract or one or several of the obligations arising under the contract dependent upon the occurrence of a future event that is bound to happen.

#### Illustrations

2. A contract of sale is concluded on October 2, with the delivery of the goods to be made on October 10. The obligation to deliver is not conditional because it is not subject to a future uncertain event.

3. A Ltd and B SpA enter into an agreement on January 1 by which A Ltd appoints B SpA as A's distributor for the distribution, within a defined area, of goods manufactured by A. The appointment is to take effect on April 1 and is to last for a period of three years from that date. The arrival of the commencement and termination dates is not a condition because it is certain to occur.

The parties may provide in their contract a time by which the condition has to have occurred.

#### Illustration

4. A share purchase agreement is concluded between A and B. It will take effect if all necessary authorisations are received by January 30. The agreement is conditional and it includes a date by which the condition has to have occurred if the parties' obligations are to come into effect.

If the contract does not state a specific time by which the condition must occur, in appropriate circumstances, the time may be implied based on an interpretation of the parties' intentions under Chapter 4 of these Principles.

### **3. Suspensive and resolutive conditions**

A contract or contractual obligation can be made to depend upon the occurrence of a future uncertain event, so that it takes effect only if the event occurs. This is known as a suspensive condition. This is also known as a "condition precedent".

#### Illustration

5. A takeover contract is concluded between A and B subject to A having received the necessary antitrust clearance for the transaction from the relevant authorities before a specific date. This is a suspensive condition. The contract takes effect only if the necessary antitrust clearance is provided.

A contract or a contractual obligation can be made to terminate upon the occurrence of a future uncertain event. A provision to this effect is known as a resolutive condition, or condition subsequent.

#### Illustration

6. A contract appointing Grundnorm GmbH as a fund manager to manage the investments of a company provides that the agreement is automatically to come to an end if the fund manager loses its licence from the authorities to conduct the

business of fund management. This is a resolutive condition, or condition subsequent. If Grundnorm subsequently loses its licence the contract terminates.

#### **4. Condition entirely dependent on the will of the obligor**

Sometimes the contract or contractual obligation is made dependent upon an event which is entirely in the discretion of the obligor. Here the question arises whether the obligor really wants to be bound. This is a problem of interpretation. If it appears that there is no intention to be bound, there is no contract nor any contractual obligation.

##### **Illustration**

7. A document for a commercial sale between A and B contains a list of "conditions precedent". Among these conditions, one says that a contract of sale will come into being if A decides to sell the goods. The decision is within A's free (unfettered) discretion. There is no conditional obligation since A can refuse to enter into the contract. The fact that this may be subject to A's precontractual obligation not to act in bad faith is, in this respect, irrelevant.

In some cases, there is a conditional obligation in spite of the fact that one party has a choice to conclude or not to conclude the contract. This holds true when the freedom of choice is in fact dependent upon external elements.

##### **Illustration**

8. 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. The supervisory board can only withhold its agreement for good reasons. This is not an unfettered discretion. There is a conditional obligation, since the condition is not entirely dependent on the will of a party.

#### **5. 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. In actual practice, there are mixed provisions. Thus, for instance, events such as the receipt of all necessary antitrust clearance, the admittance to trading on a stock exchange, the granting of an export licence, and the obtaining of a bank loan, may be true suspensive conditions because they are events that are not certain to occur. Other terms such as the accuracy of one party's representations or warranties, the commitment to perform or abstain from some specific acts, and the submission of a tax certificate that evidences that no taxes are due by the party concerned, are in fact obligations that the parties have agreed to fulfill before the formal conclusion ("completion") of the transaction. These

are not events that are uncertain to occur, and therefore these provisions are not conditions under the Principles.

Also, with respect to the effects of a “closing”, there is no clear cut rule as to whether a term is a condition or not. In practice it is difficult to draw a logical answer from the clauses themselves. In particular, clauses named “conditions precedent” often mix up real conditions and specific matters which still need to be agreed upon or real obligations that the parties must fulfill in the course of the negotiations (see Article 2.1.13).

### Illustration

9. A Share Capital Increase Agreement negotiated between Issuer A and Lead Manager B, under the heading “Conditions precedent” provides as follows:

“The obligation of the Lead Manager 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 :

- a. Accuracy of representations and warranties;
- 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;
- d. Delivery of any and all closing documents: the Lead Manager shall have received the following documents on or before the closing date [...].

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 Manager may be terminated by the Lead Manager.”

In this illustration the contract consists of a mixture of legal obligations and suspensive conditions. Item (c) is a suspensive condition, being outside the control of the parties. Items (a) and (b) embody contractual obligations. Item (d) embodies a contractual obligation as regards documents a party is under an obligation to procure but a suspensive condition as regards other documents.

## Article 2

*(Effect of conditions)*

**Unless the parties otherwise agree :**

**(a) the relevant contract or obligation takes effect upon fulfilment of a suspensive condition;**

**(b) the relevant contract or obligation comes to an end upon fulfilment of a resolutive condition.**

### COMMENT

#### 1. A general default rule

Under these Principles, unless the parties otherwise agree, the fulfilment of a condition has prospective effect only. It does not operate retrospectively.

If parties wish to depart from this rule, they should do so in a clear manner. Parties should be encouraged to express whether a condition operates retrospectively or prospectively.

## **2. No retrospective effect**

In the case of a suspensive condition, the contract or contractual obligation automatically becomes effective from the moment the future uncertain event occurs.

### Illustration

1. An international share purchase agreement is concluded subject to receipt of the necessary antitrust clearance for the transaction from the necessary government agencies. The contract becomes effective when the necessary antitrust clearance is received.

In the case of a resolutive condition, the contract or contractual obligation comes to an end from the moment when the future uncertain event occurs.

### Illustration

2. A contract appointing Grundnorm GmbH as a fund manager to manage the investments of a company provides that the agreement is automatically to come to an end if the fund manager loses its licence from the authorities to conduct the business of fund management. This is a resolutive condition, or condition subsequent. If Grundnorm subsequently loses its licence the contract terminates.

## **Article 3**

### *(Interference with conditions)*

**(1) If fulfilment 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-fulfilment of the condition.**

**(2) If fulfilment 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 fulfilment of the condition.**

### COMMENT

This rule on interference with conditions is a specific application of the general principles dealing with good faith and fair dealing (Art. 1.7), inconsistent behaviour (Art. 1.8) and co-operation between the parties (Art. 5.1.3).

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, contrary to the duties of good faith and fair dealing or co-operation, prevents the condition from being fulfilled may not rely on the non-fulfilment of the condition; if, on the contrary, it brings about the fulfilment of a condition, it may not rely on the fulfilment of the condition.

Whether or not a party is under an obligation to use all reasonable efforts to cause a condition to be fulfilled is a matter of interpretation. In commercial practice, parties may themselves expressly state a principle of good faith as regards all the events upon which completion of the transaction is conditional or go beyond the minimum standard 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 (Art. 5.1.4).

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

Four factual situations can be distinguished to illustrate the operation of the present article.

(i) If the fulfilment of a suspensive condition is prevented by a party, contrary to the duties of good faith, fair dealing and cooperation, that party may not rely on the non-fulfilment of the condition.

#### Illustration

1. The licensing of software by B to A is agreed by the parties to be dependent upon the professional approval of the software by an independent computer engineer, C, who is nominated by B. B regrets the bargain and bribes C to disapprove of the software. Because of the bribe, C states that it disapproves of the software. B is not allowed to rely on the non-fulfilment of the condition, i.e. B cannot refuse to perform the obligation under the contract when asked by A to do so.

(ii) Where the fulfilment of a resolutive condition is prevented by a party, contrary to the duties of good faith and fair dealing and cooperation, that party may not rely on the non-fulfilment of the condition.

#### Illustration

2. A in London contracts to sell to B in Hamburg equipment for the export of which a licence is required from the responsible government agency. The contract provides that it will come to an end if A fails to obtain the requisite licence by a given date. A, who had a reasonable prospect of obtaining the licence, neglects to apply for it before the specified date. A cannot invoke the fulfilment of the condition as a ground for treating the agreement as at end. Though the absence of a licence may preclude delivery, A is liable to B for damages for non-delivery.

(iii) If the fulfilment of a suspensive condition is brought about by a party, contrary to the duties of good faith and fair dealing and cooperation, that party may not rely on the fulfilment of the condition.

### Illustration

3. The facts are the same as in Illustration 1, except that B bribes C to give its approval of the software despite C's professional misgivings about the software. B is not allowed to rely on the fulfilment of the condition, i.e. B cannot ask A to perform the contract.

(iv) If the fulfilment of a resolutive condition is brought about by a party, contrary to the duties of good faith and fair dealing and cooperation, that party may not rely on the fulfilment of the condition.

### Illustration

4. A appoints B its agent for the promotion and sale of A's products. The agreement is to come to an end if the gross amount of sales made by B fails to reach one million euro by 31 December 2012. A, who has found another party willing to act as agent on terms more favourable to A than under its agreement with B, withholds supplies to B, with the result that B's gross sales by the above date fall well short of one million Euro. A may not rely on this to treat the agreement with B as at an end.

This example is based on automatic resolutive conditions. In practice it is more common for one party to be given the right to terminate the contract if the resolutive condition occurs. In the above example, A, who is given the right of termination, could not exercise it because it is A itself who is responsible for the resolutive condition.

## Article 4

*(Duty to preserve rights)*

**Pending fulfilment of a condition, a party may not act, contrary to the duty of good faith and fair dealing, so as to prejudice the other party's rights in case of fulfilment of the condition.**

### COMMENT

This rule only relates to the acts performed during the period which precedes the time the condition is fulfilled. It does not concern acts which amount to an interference with conditions. These are dealt with by Article 3.

The situation pending the condition is very specific. Therefore it deserves special treatment despite the fact that there is a general rule on good faith (Art. 1(7)).

This rule is based on the following concern. 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 provision is also important as a reminder to the parties who enter into a conditional contract 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, parties may draft a specific provision (known as “covenant”) “of ordinary course of business” which produces effect between the date of signature and the closing date and restricts the parties’ rights to certain types of acts (ordinary acts of “*gestion*”) on their goods while for more important acts, parties must reach an agreement.

In the absence of specific contractual provisions by virtue of this article, the parties may have to assume a certain number of binding obligations that are necessary for preserving the basis of their agreement and the object of the contract.

### Illustration

1. 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 are met, including B’s having obtained from its banks the necessary credit. A is bound to restrict its 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

### Article 5

*(Restitution in case of fulfilment of a resolutive condition)*

**Unless the parties otherwise agree, on fulfilment of a resolutive condition, the relevant rules on restitution apply.**

### COMMENT

When a contract subject to a resolutive condition comes to an end because of the fulfilment of the resolutive condition, the parties will often have performed, fully or in part, their obligations under the contract. The question then arises whether and, if so, under which rules, the parties will have to make restitution of what they have received.

The parties may draft a clause which attributes retroactive effect to their resolutive condition (Art. 2) or they may even provide for a different restitution regime.

In the absence of such provisions the Principles have two general restitution rules. One rule deals with restitution following avoidance of the contract. The other rule deals with restitution following termination. The characteristic feature of the rules on restitution after termination is that, for contracts to be performed over a period of time, restitution cannot be claimed for the period prior to termination of the contract. That is also the case if a contract performed over a period of time and subject to a resolutive condition comes to an end because of the fulfilment of the resolutive condition, provided that the parties have either expressed that the condition applies prospectively or the condition applies prospectively under the default rule in Art. 2. If, on the other

hand, the parties provide that the condition shall have retrospective effect, the rules on restitution following avoidance apply.

#### Illustration

1. A contracts to service B's computer hardware and software for a period of five years. After three years of regular service A is obliged by illness to discontinue the services and the contract is terminated. B, who has paid A for the fourth year, can claim return of the advance payment for that year but not for the money paid for the three years of regular service.

Since the contract is terminated only for the future, any outstanding payments for partial performances can still be claimed. Art. 2 also, of course, does not prevent a claim for damages being brought.

#### Illustration

2. A license agreement is concluded under the resolutive condition that the patent is not invalidated. The parties have provided that the condition shall have retrospective effect. When the patent is invalidated, the contract comes to an end. Restitution is due retrospectively for all performances exchanged under the contract (see Art....).