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## **Chapter 5**

### **Draft Section 3**

#### **Conditions**

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## Section 3: Conditions

### Article 5.3.1 *(Types of conditions)*

**A contract or a contractual obligation may be made conditional upon the occurrence of a future uncertain event, so that the contract or the contractual obligation only take 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.

Conditions governed by these Principles include both those that determine whether a contract exists and those that determine obligations within a contract. Accordingly, application of these Principles may in some circumstances impose duties even in the absence of a contract (see e.g. articles 3 and 4).

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

This Section only deals with conditions that originate in an agreement of the parties.

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 Article 6.1.14. However, if parties introduce a provision 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" they merely specify the obligations of both parties under their contract.

### Illustration

1. In a share purchase and sale agreement concluded between seller "A", incorporated in country "X", and purchaser "B", incorporated in country "Y", B's obligation to pay the agreed price is subject to the seller having "performed all of its obligations hereunder to be performed on or before a certain 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. Architect A, who intends to renovate his offices, borrows money from a bank and the loan agreement provides that title to a particular property he owns will become property of the bank on his death. This is not a condition since A's death 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. Under these Principles this is a suspensive condition. It is sometimes also known as "condition precedent".

#### Illustration

5. A merger 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.

A contract or a contractual obligation can be made to come to an end upon the occurrence of a future uncertain event. Under these Principles this is a resolutive condition. It is sometimes also known as "condition subsequent".

#### Illustration

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

Instead of agreeing on a resolutive condition, the parties to a contract may agree that one or both of them may, under certain circumstances, have the right to terminate the contract.

#### **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 drawn up between A and B contains a list of provisions. One of them states that a contract of sale will come into being if A decides to sell certain goods. There is no obligation, not even a conditional obligation, on the part of A, in view of the fact that it is within A's unfettered discretion to decide whether he wants to sell the goods. The fact that A may be under a 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. An international merger agreement provides for the merger within a period of time of two subsidiaries of the parent company, subject to the approval of the board of directors of one of the companies which under the applicable law cannot be unreasonably withheld. There is a conditional obligation since the condition is not entirely dependent on the will of one of the parties.

#### **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 5.3.2**  
*(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.

Parties are 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. The facts are the same as in illustration 5 to article 1. The contract takes effect, if and when the necessary antitrust clearance is provided.

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. The facts are the same as in illustration 6 to article 1. The contract comes to an end, if and when B loses its licence.

### **Article 5.3.3**

*(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 (Article 1.7), inconsistent behaviour (Article 1.8) and co-operation between the parties (Article 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 (Article 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 hires from B an earth moving equipment during the necessary time for A purchasing its own equipment. As a commercial favour to A, the rate of hire is below the market rate. B's obligation to make the earth moving equipment available is subject to the resolutive condition that it comes to an end if A acquires its own earth moving equipment. A turns down very attractive offers in order to continue benefiting from the favourable rate of hire. A may not rely on the non-fulfilment of the condition.

(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.

#### Article 5.3.4

*(Duty to preserve rights)*

**Pending fulfilment of a condition, a party may not, contrary to the duty to act in accordance with good faith and fair dealing, act 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 fulfilment of the condition is specific and deserves a special treatment along the same line as the general rule on good faith (Article 1(7)). Indeed, a person who would benefit from the fulfilment of a condition has a conditional right which necessitates

protection (particularly in the case of a suspensive condition). During this period of time one 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 to consider this issue and even expressly state which measures the person who would benefit from the fulfilment of the condition may take in order to preserve his/her rights. Actually, 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 dispose of the assets if it is not a type of act which falls within the ordinary course of business.

#### Illustration

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 5.3.5**

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

**On fulfilment of a resolutive condition, the rules on restitution set out in articles 7.3.6 and 7.3.7 apply with appropriate adaptation.**

**If the parties have agreed that the resolutive condition is to operate retrospectively, article 3.2.15 on restitution applies with appropriate adaptations.**

#### 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.

Under these Principles, the fulfilment of a resolutive condition normally has prospective effect only. That is why restitution will have to follow the regime set out in articles 7.3.6 and 7.3.7, dealing with restitution following termination of a contract. Termination also only operates prospectively. The specificity of this restitution regime vis-à-vis the restitution regime set out in Article 3.2.15 is that for contracts to be performed over a period of time, restitution cannot be claimed for the period prior to the moment when the contract has come to an end.

However, under these Principles, parties are free to determine that a resolutive condition is to operate retrospectively. Under these circumstances it appears to be appropriate to apply the restitution regime set out in Article 3.2.15 (Restitution following avoidance) since avoidance also operates retrospectively. There is no special rule for restitution relating to contracts performed over a period of time.