The New Provisions on Conditions in the UNIDROIT Principles 2010

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INTRODUCTION

The subject of “conditions” was one of the topics retained by the Governing Council of UNIDROIT for possible inclusion in an enlarged third edition of the UNIDROIT Principles of International Contracts (hereinafter: “UNIDROIT Principles” or “Principles”). At its meeting in Rome from 29 May to 1 June 2006, the Working Group preparing the third edition decided to deal with this topic. The matter is now the subject of the new Section 3 of Chapter 5 of the UNIDROIT Principles 2010.

The solutions provided by significant earlier codifications were considered by the Working Group. Special attention was given to international or European codifications, particularly to the Principles of European Contract Law (hereinafter: PECL) (Chapter 16) and, later, to the Draft Common Frame of Reference (hereinafter: DCFR) published in 2008 (Article III.-1:106), as well as to various national laws on contracts and to the provisions on conditions of the Preliminary OHADA draft Uniform Act on the law of contracts (prepared by Professor Marcel Fontaine). The discussions of the Working Group are summarised in the Summary Records which are available on the UNIDROIT website.  

In commercial practice, disputes often arise relating to conditions. The terminology fluctuates and this affects the clarity of the rules. Some members of the Group expressed doubts as to the usefulness of provisions on conditions, arguing that the provisions on contract interpretation contained in the Principles were sufficient. However, the majority was of the opinion that conditions were

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an important subject and that a clear regime, with an accepted terminology, had to be set up. In actual practice, there are many problems with conditional contracts that parties usually neglect. The rapporteur benefited from discussions of the Working Group on International Contracts (GTCl), a group of international specialists involved in international contracts, founded by Professor Fontaine and currently chaired by Professor Filip De Ly. This Group was actually working on clauses dealing with conditions when the relevant Articles of the UNIDROIT Principles were being elaborated.

The rules on conditions are a key element in many legal traditions. As stated in the notes of the DCFR, “They can be traced back in some instances to the earliest records of Roman law and have formed an unbroken thread in the European legal tradition for many centuries.”

Two fundamental concerns guided the work of the Group: simplicity and clarity. Consequently, the chapter on conditions only contains five articles, whereas initially, many more texts had been presented to the Group. The main purpose of the section on conditions is to establish a recognised model to apply in situations in which the parties have not expressly provided otherwise.

This paper is divided into three parts.

Part I deals with the notion of “condition”. Starting with a presentation of Article 5.3.1, it goes on to provide a further analysis based on the discussions of the Working Group, which encompassed many aspects that were not in the end covered in the black letter rules and not necessarily dealt with in the Comments.

Part II follows the same method in relation to the effects of conditions (Articles 5.3.2 and 5.3.5).

Part III deals with two specific texts that, in some respects, may appear as specific applications of the general principle of good faith and fair dealing (Articles 5.3.3 and 5.3.4).

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5 Draft Common Frame of Reference (DCFR), Full Ed., vol. 1, Sellier (2009), 695.
I. – THE NOTION OF “CONDITION”

A. Presentation

- Article 5.3.1 (Types of conditions) states that “A contract or a contractual obligation may be made conditional upon the occurrence of a future uncertain event, so that the contract or the obligation only takes effect if the event occurs (suspensive condition) or comes to an end if the event occurs (resolutive condition).” 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. Article 5.3.1 covers conditions which apply to contractual obligations or to the existence of the contract itself (the civilian notion of a condition only relates to contractual obligations, not to contracts).

Article 5.3.1 is a classical text insofar as it distinguishes between two types of conditions: 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 a suspensive condition (sometimes also known as “condition precedent”). A contract or a contractual obligation can be made to come to an end without any further notice upon the occurrence of a future uncertain event. This is a resolutive condition (sometimes also known as “condition subsequent”).

Article 5.3.1 makes it clear that this section only deals with conditions that originate in an agreement of the parties. In other words, conditions imposed by law are outside the scope of this section (a public permission requirement imposed by law may be governed by Article 6.1.14). However, if a condition imposed by law is incorporated by the parties into their contract, it then becomes contractual and may be covered by this section. Thus, if parties specify in their contract that their contract or contractual obligations arising under it are dependent upon a public permission being granted, that provision may be subject to the rules of this section. In practice, this may benefit the party who does not succeed in fulfilling the condition. Unless it is proved by the other party that it interfered with the fulfilment of the condition, that party is not responsible for the non-fulfilment of the condition while, if it is a requirement imposed by law, the party who does not meet this requirement (for instance, does not obtain the administrative authorisation) is liable.

A condition may concern all manner of events, including natural events or acts of a third party.
The notion of condition was not an easy subject, due to the various meanings that the word condition may have, both in law and in normal life. It was agreed to exclude the meaning given to the word in some common law jurisdictions, notably in England, where the word “condition” means a major term of the contract.

When the contract provides that the performance by one party is dependent upon the performance of the other party, this is not a condition. It is a contractual provision which specifies the obligations which the other party is required to perform.

In the Comments, the developments under the heading “Closing” are innovative and were particularly difficult to draft. For this purpose, the input of all members of the Group as well as of practitioners who attended as observers, and discussions with other practitioners (particularly during the meetings of the GTCI) was most valuable. These developments on closing do not exist in the other models (PECL, DCFR).

On the “closing date”, the parties usually sign a document which confirms that no “condition precedent” survives or, if some conditions have not been satisfied, they have been waived. The Comments explain that “[d]espite the terminology used by the parties, not all the events referred to as ‘conditions precedent’ are ‘conditions’ as defined by this 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 fulfil 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 or not a term is a condition. 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 fulfil in the course of the negotiations (see Article 2.1.13).”
The Illustration which follows the Comments concerns a Share Capital Increase Agreement and clearly shows how there can be, in one long provision, a mixture of legal obligations and suspensive conditions.

B. Further analysis

As already noted, a great variety of meanings are attached to the term “conditions”. This is true not only within common law systems but also within civil law systems where historically, breach of contract or the clausula rebus sic standibus or hardship were considered as conditions.

The importance of a precise definition of the notion of “conditions” was raised by members of the Group who illustrated the consequences of adopting too broad a definition, especially as regards performance and non-performance. Some members of the Group felt that it would be useful to draw up a list of contracts which are truly “conditional” and those which are not, although they may be called “conditional”. Yet, practice is too complex to carve out such a classification.

Condition and term are, in civil law systems, both differentiated (separate articles in the Codes) and closely associated. From the start, there was a discussion within the Group concerning the respective meanings of “condition” and “term” and whether it would be opportune to insert some specific provisions on “terms”. It was thought that Articles 6.1.1 et seq., as well as Article 1.12, already addressed most of the issues normally dealt with in the Civil Codes under the heading “terms”, which really is a question of “delay”, “time limit” or “due date”. It was also noted that the use of the word “term” might carry a risk of confusion for common law lawyers who would understand it as referring to the terms of the contract. Although some expressed the view that the concept has now become international (see, for instance, the Chinese law on contract which refers to the “term”) and that the word could therefore be kept, others preferred a more neutral word, such as “delay”, “time limit” or “due date”.

While the occurrence of a “delay” is certain, that of a “condition” is uncertain. In the past, retroactivity was sometimes considered by scholars from legal systems inspired by the Justinian’s Digest (Digest, 20.4.11.1), as a

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7 See the example given by Sir Roy Goode (Summary Records, para. 222).
8 Summary Records, 29.
distinctive feature of condition, which makes it distinct from a “term”. However, this is no longer a distinctive feature since most legal systems have put aside the retroactivity rule for condition (see infra, for the solution adopted by the UNIDROIT Principles).

If the parties use the word “term” for an uncertain event, the judge should re-qualify the event since it is in fact a condition, and vice versa.

The Working Group decided not to follow the civilian models which usually have many more rules on conditions.

There are no rules on impossible or unlawful conditions (PECL and the DCFR have no specific text either). On the contrary, the OHADA draft (10/2) contains provisions on this subject. In the new version of the UNIDROIT Principles, the new rules on illegality may apply.

After some discussion, the Working Group also decided not to insert a rule on discretionary condition or “condition potestative”, contrary to many civilian models and to the OHADA draft (Article 10/3: “An obligation that depends upon a condition that is at the sole discretion of the obligor is null”).

The reasons for the absence of such a rule are explained in the Comments, under the heading “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. In this case, the question is whether the obligor really wants to be bound. This is a matter of interpretation. If it appears that there is no intention to be bound, there is no contract, nor is there any contractual obligation.” Another view, expressed by some members of the Group, is that the contract is null or void.

In some commercial situations, the party who has a choice to conclude or not to conclude the contract has no unfettered discretion and can only withhold its agreement for good reasons. In that case, there is a conditional obligation.

Under French law, which has the concept of condition potestative, a subtle distinction is made between conditions that are “simplement potestatives”, which are valid, and “conditions purement potestatives”, which are invalid because they entirely depend upon the sole capricious/discretionary/arbitrary will (“arbitraire/discrétionnaire”) of the debtor. Would it not be much simpler to say that the latter are not conditions since one party is not bound?

II. – EFFECT OF CONDITIONS

A. Presentation

- Article 5.3.2 (Effect of conditions) states that “Unless the parties otherwise agree: (a) the relevant contract or contractual obligation takes effect upon fulfilment of a suspensive condition; (b) the relevant contract or contractual obligation comes to an end upon fulfilment of a resolutive condition.” Article 5.3.2 applies as a general default rule, which means that the parties may always “otherwise agree”. For reasons of predictability, parties are advised clearly to express whether a condition operates retroactively or prospectively. If they have not done so, the fulfilment of a condition has prospective effect only. It does not operate retroactively.

In practice, this solution entails the following.

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

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

- Article 5.3.5 (Restitution in case of fulfilment of a resolutive condition) deals with restitutions in case of fulfilment of a resolutive condition. It states that “(1) On fulfilment of a resolutive condition, the rules on restitution set out in Articles 7.3.6 and 7.3.7 apply with appropriate adaptations; and (2) If the parties have agreed that the resolutive condition is to operate retroactively, the rules on restitution set out in Article 3.2.15 apply with appropriate modifications.” The reason why the scope of Article 5.3.5 is limited to resolutive conditions is self-evident. When a resolutive condition is fulfilled, the contract comes to an end. Often, the parties have performed, fully or in part, their obligations under the contract. The parties may have anticipated such difficulties, either by attributing retroactive effect to their resolutive condition (paragraph (2)) or by providing for a specific restitution regime.

This provision only applies in the absence of such specifications. It operates a “renvoi” to the two general restitution rules which were inserted in the 2010 edition of the UNIDROIT Principles.

B. Further analysis

The effects of the occurrence of a condition raise the difficult question of retroactive vs. prospective – ex tunc or ex nunc - effect? There was a broad
consensus in the Group against retroactive effect, primarily for practical reasons. Besides, there is a trend, in modern contract law, towards abolishing the concept of retroactivity. The UNIDROIT Principles themselves adopted this approach in their previous editions, with respect, for instance, to termination of contract for breach and set-off.

For the parties who have a choice, it is important to make clear the consequences of non-retroactivity/retroactivity. In case of non-retroactivity, when the suspensive condition occurs, the period of “suspension” automatically comes to an end and the conditional act automatically produces its effect, as any other act (ex nunc). The creditor can therefore only ask for its due (for example, interest) from the moment the condition occurred; limitation of action only starts to run from that precise moment. This is the rule, for instance, in Germany (Bürgerliches Gesetzbuch (BGB) § 158) and in Switzerland (Code des obligations (CO) 151.2), subject to some exceptions.

In case of retroactivity of a suspensive condition, it is as if the conditional right had been perfect from the very beginning. The main consequence is that it validates the acts accomplished pendente conditione by the person who benefits from the condition. This is particularly important in relation to sales contracts. For instance, if the person who benefits from the condition has sold the goods before the condition is fulfilled, upon fulfilment of the condition, this sale is valid. Under French law, a condition has a retroactive effect (1179, 1183 C. civ.). However, this retroactive effect is subject to various kinds of exception: the parties’ agreement, transfer of risks (1182 al. 2 C. civ.), tax rules.

In case of non-retroactivity of the resolutive condition, which is the solution adopted by the UNIDROIT Principles, the obligation exists in full. Therefore, if the condition does not occur, the contract is perfect. If it does occur, since the contract existed before the condition took place, remedies are available (see supra).

In fact, even if national legal systems are divided (retroactivity/no retroactivity), in actual fact, the solutions are not so very different from one another. Take, for instance, the French and German legal systems. While there are many exceptions to the retroactivity rule in the French legal system, under German law, the person who benefits from the condition may either ask

10 For a list of countries where there is no retroactive effect, such as Germany, and of those where, as in France, effect is retroactive, see DCFR, supra note 5, 698.
for damages if, *pendente conditione*, its rights were diminished, or ask for ineffectiveness of dispositions during the period of suspension (BGB § 161).

Among the various projects that were published in view of a French reform of the law of contracts, which is still awaited and has not yet been adopted, the “Avant-Projet de réforme du droit des obligations et de la prescription” (also known as the “Catala Project”), 11 has maintained the retroactivity rule, in spite of its having been abandoned, many years previously, by a former reform Commission whose work on reforming the law of obligations never came to fruition. The following reasons were given in the “exposé des motifs” by the drafters of this part of the Catala project: “On one particular point the Reform Proposals reject the model bequeathed by the Commission for the Reform of the Civil Code [Author’s note: the work of this Commission, which was set up in the middle of the twentieth century, never came into force]. The Commission’s giving up of the principle of retroactivity of fulfilled suspensive conditions, which was settled on following a change of opinion, has failed to convince: retroactivity is justified on both theoretical and practical grounds, and removing it inevitably requires a provision that during the period of uncertainty, the debtor must behave in accordance with good faith and without doing anything that might harm the other party’s interests – tests which may be uncertain and difficult to apply. It should be noted that the Quebec Code retains retroactivity (Article 1506) and that all the present “European” legislation or proposals for reform which remove it, still allow it to be restored if the parties expressly so provide. Our Reform Proposals take the opposite path; faithful to the present law, they retain retroactivity, but qualify its *effects*, or allow the parties to reject it altogether, if they think it preferable.” 12 It is hoped that the final draft elaborated by the Ministry of Justice will abandon retroactivity and that the reform of the French law of contracts will eventually come into force.

III. – THE SPECIFIC ROLE OF GOOD FAITH

Article 5.3.3 contains rules on interference with conditions and Article 5.3.4 deals with the duty to preserve rights pending fulfilment of the condition.

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12 Extract from the preface by J.-J. TAISNE to the section on “Conditional, Time-delayed, Alternative and Discretionary Obligations” (Arts. 1173 to 1196). The official English version of the Catala Report was prepared by J. CARTWRIGHT and S. WHITTAKER (Oxford University) and is available at <http://www.justice.gouv.fr/art_pix/rapportcatala0905-anglais.pdf>.
Both texts are important, in spite of there being a general principle of good faith in Chapter 1 of the UNIDROIT Principles (Article 1.7). This is due to the specificity of each situation.

A. Interference with conditions

- Article 5.3.3 (Interference with conditions) states that “(1) If fulfilment of a condition is prevented by a party, contrary to the duty of good faith and fair dealing or the duty of 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 duty of good faith and fair dealing or the duty of co-operation, that party may not rely on the fulfilment of the condition.”

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

Although there was no unanimity in this respect, the majority of the Working Group was in favour of such a rule. This is particularly important for those who are not familiar with the general principles of good faith and co-operation and who would not necessarily infer such a rule from the existence of these general principles in Chapter 1. Besides, such a provision exists in PECL (Article 16:102) and DCFR (III.- I:106 (4)).

The rule simply states that the party who interfered with the condition “may not rely” on the fulfilment/non-fulfilment of the condition. In other words, this rule 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 that condition.

The rule leaves the actual consequences of fulfilment and non-fulfilment open. The result of improper interference may take various forms and this is why the expression “the condition is deemed to be fulfilled” was considered to be inappropriate (see PECL, comp. the DCFR which states that “the other party may treat the condition as not having been fulfilled or as having been fulfilled as the case may be.”). Besides, in English law, interference would usually be treated as a breach of an implied term of the contract but it would not deem fulfilment or non-fulfilment to have occurred.

This rule does not go so far as to impose on the party a duty to use all reasonable efforts to cause the conditions to be to be fulfilled. 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. Parties may themselves decide to go beyond the minimum standard imposed by this rule and expressly state a duty to use “their best efforts to bring about the fulfilment of the conditions as soon as practicable.” They may also specify the available remedies (right to performance or damages). If they have not done so, remedies are determined in accordance with the other contractual provisions and the general rules on remedies as well as with the particular circumstances of the case.13

In the Comments, four Illustrations are given in order to clarify the operation of this Article in four situations:

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

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

(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 co-operation, that party may not rely on the fulfilment of the condition.

B. Duty to preserve rights

- Article 5.3.4 (Duty to preserve rights) states that “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.” This Article deals with a very different situation from the one dealt with in Article 5.3.3. It only applies to the acts performed during the period which precedes the time when the condition is fulfilled, and not to acts which amount to an interference with conditions.

The Working Group decided, after intense discussions, that pending fulfilment of the condition, the situation is so specific that it necessitates a specific rule, similar to the general rule on good faith (Article 1.7). Those who

13 Comment to Art. 5.3.3.
were in favour of including a special provision put forward the following reasons:

– This is a necessary corollary of the non-retroactive effect (see similar provisions in some national Codes).
– The situation *pendent conditionem* is different from breach of contract in general and therefore deserves special treatment.
– The provision is important both in arbitration proceedings and as a reminder to the parties who enter into a contract under a condition to consider this issue.

It was also hoped that this provision would remind the parties to consider this issue and draft a specific provision (known as “covenant of ordinary course of business”). As explained in the Comments, this provision “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.”

**FINAL REMARKS**

These rules on conditions do not purport to deal with all the difficult questions that may arise. They provide a general, flexible framework for the parties whose contractual freedom remains paramount. They highlight the importance of a codified model and reflect the conviction of the Working Group that there is a real need for non-mandatory rules in practice. Yet they do not set out to unify the laws. The great added value of this section also lies in the Illustrations which were carefully suggested, discussed and commented upon by all those present during the working sessions.

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