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Draft Chapter
on
Conditional Obligations

by

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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, 2008 and 2009.

This document has been prepared after the Rome meeting of May 25-29, 2009.

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Article 1
(*Types of Condition*)

A contractual obligation may be made conditional upon the occurrence of an uncertain future 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 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.

A condition may refer to a natural event, to an act of a third party, to the availability of a permit or something else.

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.

A condition imposed by law is made conditional when it is incorporated in the contract. Consequently, all articles in this chapter are applicable to conditions imposed by law that are stated as conditions in the contract.

If a public requirement is imposed by law and is not expressly stated as a condition in the contract, the party who was due to comply with it but has not done so is in breach of contract. Articles 7.1. et seq. PICC on non performance then apply.

Most practical aspects of public permission requirements are already covered by PICC, Art. 6.1.14 et seq.

2. Notion of condition

“Condition” may have a number of meanings. For the purpose of this chapter it is intended only however to refer to future uncertain events.

In that respect, it is distinct from what in some jurisdictions is called a “term” and designates a future but certain event.

The fact that the condition incorporates a time of occurrence does not change the nature of the conditional obligation. Time of occurrence 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 obligation will take effect if all necessary authorisations are given. The obligation is conditional (suspensive condition).

2. The obligation will take effect if all necessary authorisations are given before January 30. The obligation is conditional (suspensive condition) and the condition incorporates a time of occurrence.

3. 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. This is not a conditional obligation.

4. A is bound to pay C *when* B dies. The obligation to pay is future but certain. B's death will arrive. This is not a conditional obligation.

A condition may or may not state a time of occurrence.

Illustration

5. 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 occurrence.

If the condition does not state a time of occurrence, such a time 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 ».

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 normally a case of breach of contract

Illustration

6. In a share capital increase, the obligation of the lead managers at the closing date to subscribe for the shares is subject to a condition named “performance of undertakings”, which provides that “the issuer has performed all of its obligations hereunder to be performed on or before the closing date”. This is not a condition. If issuer has not performed all of its obligations at closing date, the lead managers are freed of their obligation to subscribe for the shares and can sue for breach of contract (subject to what is said about closing in paragraph 6).

3. Suspensive and resolutive 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

7. The contract is concluded under the “condition precedent” of receipt of all necessary antitrust clearance for the transaction from relevant authorities.

There is a resolutive 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 resolutive condition is often named “condition subsequent”.

Illustration

8. A commercial contract is to be terminated if a new technology makes the know-how licence obsolete.

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 the benefit of a 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 suspensive condition

If, from the very beginning, the event on which is based a suspensive condition is impossible (initial impossibility), there is 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

9. 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. The obligation cannot take effect.

10. The parties agree that the sale is conditional upon an export license being granted to the seller. The parties do not know that such a license cannot be granted because the government has already imposed an embargo. The obligation cannot take effect. In such a situation, the rules on mistake may come into play.

11. The parties agree that the sale is conditional upon an export license being granted to the seller. An embargo is imposed after conclusion of the contract but before the export license could be obtained. The obligation cannot take effect because the condition cannot be fulfilled any longer.

If a condition is illegal, the rules on illegality apply to the contract and may affect the validity of the contract, in whole or in part.

5. Condition entirely dependent on the will of a party

In some situations, a condition can be phrased in such a way that it seems to indicate that a party does not want to be bound. In such cases, it is necessary to look at the circumstances and to interpret the parties' intent while negotiating the contract. In order to find out what parties really intended, article 2.1.15 on negotiations in bad faith is particularly relevant.

On interpreting the contract, it may appear that there is no obligation at all, not even conditional, because of a lack of consent to be bound. However, in most cases, the discretion not to conclude the contract is not unfettered as a party who has started negotiations may not break them off in bad faith.

Illustration

12. 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 yet; parties still are at a precontractual stage. Seller can refuse to enter into the contract, subject to his precontractual obligation not to act in bad faith.

In some cases, there is a conditional obligation in spite of the fact that one party has a power not to conclude the contract. This is so with sales on approval where, in spite of this power, both parties intended to be bound. This may also be the case, in commercial contracts, when a contract is subject to the approval of the board and the board cannot unreasonably withhold its approval.

Illustrations

13. B will buy the machinery if, after one month, B is of the opinion that it meets its needs. This is a sale on approval ; in spite of its power not to buy the machinery, B intends to be bound.

14. 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.

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 fulfill before the formal conclusion ("completion") of the transaction.

Also with respect to the effects of "closing" there is no clear cut rule in practice and it is difficult to draw a logical answer from the clauses themselves. In particular, clauses named "conditions precedent" are confusing insofar as they 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 PICC). Besides, they often allow one party to withdraw from the deal by releasing it from its central obligation under the contract that is negotiated.

Illustration

15. 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 or 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: (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 Manager under this Agreement and instructing it to pay the same to the Lead Manager [...]; (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 Manager; [...].

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, some "conditions precedent" (particularly the condition of admittance to trading on stock exchange) relate to events or situations outside the control of the parties or to acts by a third party and this may be seen as an indication that a binding contract already exists before "closing", subject to one or more true suspensive conditions. On the other hand, the fact that Issuer must have performed all of its obligations before the closing date means that the issuers' obligations are real obligations that must be fulfilled in the course of the negotiations and that parties did not intend to be bound before the closing date.

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 a condition to be satisfied at the closing date is “closing” itself, that is 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
(Effect of conditions)

Unless the parties otherwise agree :
a. the relevant obligation takes effect upon fulfillment of a suspensive condition
b. the relevant obligation comes to an end upon fulfillment of a resolutive condition.

COMMENT

1. A general default rule

Under these Principles, the fulfillment 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 or several obligations.

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 is fulfilled, the conditional contract comes to an end; when it is not fulfilled 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. If renovation is finished before the end of the three year period, the contract comes to an end at the moment the renovation is finished.

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 a 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 never sold the factory and buyer as never having been the owner.

Note of Rapporteur : I received the following observations of A. Hartkamp on this illustration : *“I would not put this in. 1) the addition is only true in a system where a valid transfer requires a valid contract – which is true in France, but not in Germany. 2) In The Netherlands the system of transfer is also ‘causal’, but nevertheless the addition would not be correct. The reason is that the Code declares that the occurrence has no retroactive effect, and while it is true that parties may stipulate the contrary in their contract, that clause can only have an ‘effet obligatoire’, but not an effect in the law of property. So the factory must be retransferred to the seller and rights of third parties (e.g. a servitude granted by the buyer to the third party) will not be affected”.*

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) 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-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.

However, a duty of best efforts in one's activity is stated by article 5.1.4 Unidroit Principles.

Besides, in commercial practice, parties may themselves go beyond the minimum standard and expressly state 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.

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 regrets the bargain and bribes C to disapprove the software package. C then reckons that had he not been bribed, he would have given professional approval. A may not invoke the fact that the condition is not fulfilled. B has a choice between performance (A is bound to perform the licensing agreement) or termination of the contract with damages.
2. The same facts apply but A now fears that C will NOT give his approval and bribes C who unduly approves the package. A may not invoke the fact that the condition is fulfilled and B has the same remedies as in Illustration 1.
3. Under a joint venture agreement, A is bound only if it obtains a building permission from the local authorities. A deliberately omits to submit all the relevant documents and permit is not obtained. A may not invoke the fact that permit was not obtained. If the permission can no longer be obtained, B can terminate the contract and claim damages. If the permission can still be obtained, B can force A to take the necessary steps to obtain the building permit and ask for damages. B may of course have other remedies.

Article 4
(Duty to preserve rights)

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

COMMENT

This rule only relates to the acts accomplished during the period which precedes the moment the condition is fulfilled (“*pendente conditione*”). It does not concern acts which amount to an interference with conditions. These are dealt with by article 3.

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 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, parties may draft a specific provision (often named covenant) “of ordinary course of business” which produces effect between the date of signature and the closing date and restricts the parties' rights on their assets to certain types of acts (ordinary acts of « gestion ») while for more important acts, parties must reach an agreement.

In the absence of such a provision and irrespective of whether the parties intend to be bound by their contract only on “closing” or whether a binding contract already exists before “closing”, 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 until “closing”.

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 obtaining from its banks the necessary credit. As from the time of signature of this 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.

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.

This reminder is also true for other provisions of this chapter. See Art. 2, 2, illustration 3.

Article 5

(Restitution in case of fulfillment of a resolutive condition)

On fulfillment of a resolutive condition, the relevant rules on restitution after termination apply.

COMMENT

The rules on restitution after termination 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 arises whether either party is bound to return or pay the value of whatever has been received from the other.

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.