M&A Newsletter Series

Part 5: Conditions precedent and conditions subsequent

The purpose of this Baker McKenzie M&A Newsletter Series is to give an insight to prospective sellers or purchasers into some key legal documents and/or provisions they will most likely be confronted with when entering into any sale or acquisition process concerning a Luxembourg commercial company.

Part 5: Conditions precedent and conditions subsequent

This fifth newsletter deals with conditions precedent (conditions suspensives) and conditions subsequent (conditions résolutoires) in share sale and purchase agreements, which are used by sellers and/or purchasers in many share deals transactions.

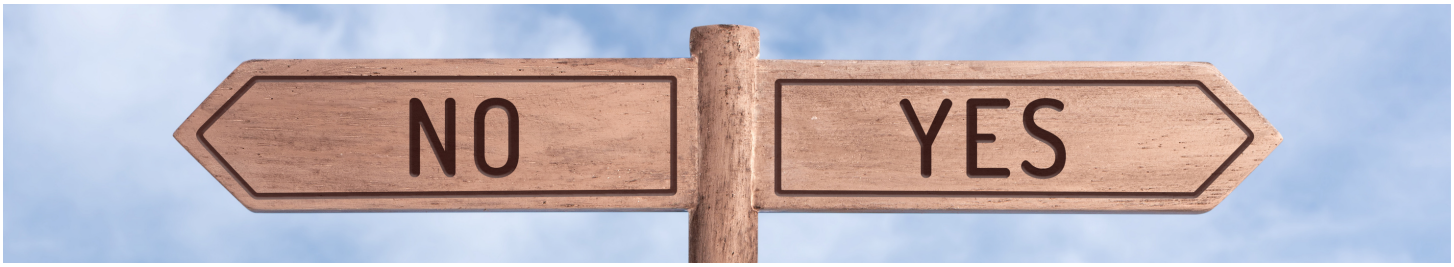
1. Conditions precedent

Any person who has practiced M&A knows that there are usually two key dates in a share deal transaction:
(a) the signing date, on which the seller and the purchaser sign the share purchase agreement relating to the target; and
(b) the closing date, on which the seller and the purchaser will only proceed later with the effective transfer of the target's shares among them.

In a large majority of cases, the obligation to have a signing date and a closing date is due to the seller and/or the purchaser needing to submit the closing of the contemplated transaction to one or several conditions precedent, which are essential for them.

Typical examples of such conditions precedent are:

(a) the prior notification of the contemplated transaction to, or the prior approval of, or absence of express objection to, the contemplated transaction by a regulatory or public authority;
(b) the delivery to the purchaser of written consents from certain key clients or suppliers of the target to confirm they consent to the contemplated transaction and agree not to exercise any termination right (or other right) arising from the contemplated transaction (e.g., change of control provisions);
(c) the passing of resolutions of the target's shareholders to approve the contemplated transfer of the shares under the contemplated transaction;
(d) the delivery of certain financing facilities to the purchaser;
(e) the release of a personal guarantee granted by the seller to secure the target's obligation; and
(f) the nonoccurrence of any material adverse change (negatively) affecting the target between the signing date and the closing date, etc.



CONDITIONS PRECEDENT ARE FUTURE AND UNCERTAIN EVENTS (ÉVÉNEMENTS FUTURS ET INCERTAINS) THAT SUSPEND (THE ENFORCEABILITY, BUT NOT THE CREATION, OF) ONE OR SEVERAL LEGAL OBLIGATIONS UNTIL THEY OCCUR

According to the Luxembourg Civil Code, conditions precedent are future and uncertain events (événements futurs et incertains) that suspend (the enforceability, but not the creation, of) one or several legal obligations until they occur. Thus, when an agreement, or an obligation thereunder, is entered into subject to the satisfaction of one or several conditions precedent, the relevant agreement or obligation exist, but may not be enforced until the satisfaction of the relevant condition(s) precedent.[1]

The uncertain nature of a condition precedent differentiates it from a deadline (terme). This uncertainty must be objective. It must exist when the obligation subject to the condition comes into existence. It must finally be external to the right or obligation it affects. This implies, for example, that the payment of the purchase price of a sale should never be made a condition precedent to the transfer of the shares and vice versa.

CONDITIONS PRECEDENT WHOSE SATISFACTION DEPENDS SOLELY ON THE WILL OF THE DEBTOR OF THE CONDITIONAL OBLIGATION (CONDITIONS SUSPENSIVES PUREMENT POTESTATIVES DANS LE CHEF DU DÉBITEUR) CAUSE PROBLEM

Conditions precedent are perfectly valid under Luxembourg law, except for conditions precedent that are impossible, illicit or prohibited by law. However, a condition precedent pursuant to which a party undertakes not to do something impossible does not make the obligation subject thereto null and void. Furthermore, conditions precedent whose satisfaction depends solely on the will of the debtor [2] of the conditional obligation (conditions suspensives purement potestatives dans le chef du débiteur) cause problems too. Indeed, any obligation subject to such a particular form of condition precedent is void [3]. Why? Because when a person is obligated only when they decide to be obliged, there was never any obligation in that person's head. Identifying such type of conditions is not always easy. However, obviously, the seller should be careful when the obligations of the purchaser to close a deal are subject, for example, to the performance of a due diligence that is satisfactory to the purchaser, the delivery of financing on terms and conditions acceptable to the purchaser, or when an agreement is entered into subject to the approval of the board of directors of a party thereto [4].

After satisfying the condition(s) precedent affecting an agreement or an obligation thereunder, such agreement or obligation becomes enforceable, with retroactive effect. However, the parties may decide to deviate from this retroactive effect, which is the case in almost all share deals.

Conversely, in case of non-satisfaction of the condition(s) precedent affecting an agreement or an obligation thereunder, it is usually deemed that such agreement or obligation should automatically become null and void or should disappear with retroactive effect as if it never existed [5]. Depending on whether practitioners consider the obligation or agreement under condition existed (or not) pendente conditione, they should be very careful about the consequences of such non-satisfaction, which will need to be treated differently.

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[1] Some authors, however, continue to consider (despite a decision of the Luxembourg Court of Appeal dated 1 April 2009) that an agreement or obligation under condition precedent does not exist until its satisfaction and cannot produce any effect.
[2] Obligations whose satisfaction depends solely on the will of the creditor of the obligation under condition being thus valid.
[3] Sometimes, there is a belief that when, under an agreement, an obligation is subject to a condition precedent whose satisfaction depends exclusively on the will of the debtor, the whole agreement would be null and void. This is an incorrect belief. Only the obligation(s) under invalid condition(s) precedent will be null and void and treated as if it never existed. The other provisions of the agreement will survive, unless the obligation(s) under condition precedent were an essential element of the will of the parties to enter into the relevant agreement.
[4] In such circumstances, some legal scholars consider that the clause is not a condition precedent, but that there is simply no agreement of the parties on the relevant contract, which would thereby remain a mere draft.
[5] However, we believe that, in accordance with the case law of the Belgian Court of Cassation, the agreement or obligation under condition precedent should simply never have to be performed, without this agreement or obligation being retroactively terminated. The agreement or obligation ceases to exist, but only in the future. This may have a significant impact in terms of a party's liability in case of a breach of a pure and simple obligation it had to perform pendente conditione.

WHEN A PARTY WRONGFULLY PREVENTS THE SATISFACTION OF A CONDITION PRECEDENT AFFECTING ONE OF ITS OBLIGATIONS, THIS CONDITION IS DEEMED TO BE SATISFIED

Finally, it is worth reminding that when a party wrongfully prevents the satisfaction of a condition precedent affecting one of its obligations, this condition is deemed to be satisfied, so that a court may declare the obligation that was under condition enforceable or may grant damages to the prejudiced party.

Subject to the above, drafting conditions precedent may seem relatively easy and straightforward. However, seasoned M&A practitioners know that many legal issues need to be carefully and systematically addressed when drafting a condition precedent provision in a share purchase agreement.

First, the parties should draft clear and simple conditions precedent that do not leave room (to the fullest extent possible) to interpretation, for preventing any discussions as to their future satisfaction.

Second, the parties should clearly determine which obligations are subject (or not) to the satisfaction of the agreed conditions precedent. The parties should start by asking themselves whether the full agreement they are entering into should be subject to conditions precedent or only part of it, and they should be reminded that any obligation under condition precedent may not be enforced pendente conditione.

Third, the parties should clearly determine the party or parties to the benefit of which each of the conditions precedent is entered into: the seller, the purchaser or both. As outlined above, a condition precedent may only be waived by the party for whose benefit it was agreed upon. Such determination will also waive any discussion as to which party or parties should be deemed to be prejudiced in case of non-satisfaction of a condition precedent and may have a claim in this respect.

Fourth, the parties would be well advised, any time the satisfaction of a condition precedent depends in whole or in part on the actions of one or several parties, to determine which of these parties should be in charge of using their reasonable or best endeavors, or, as applicable, to designate the target itself as the party in charge in order to avoid any misunderstanding as to who must do what in this respect and to have a stronger case in the event a party would prevent, by its inaction or inertia, the satisfaction of a condition precedent. In some circumstances, it may also be worth specifying the efforts expected from a party in this respect, for example, when it comes to applying for financing, by defining how many credit institutions should be contacted.

Fifth, the parties should agree to keep themselves regularly informed of the actions taken for ensuring the satisfaction of the conditions precedent and their progressive satisfaction, to be ready in due time for the closing.

Sixth, the parties should agree on a long-stop date for the satisfaction of the conditions precedent. In the absence of any such express long-stop date, the conditions precedent will survive as long as they are not satisfied or as long as a party can demonstrate that the non-satisfaction of the conditions precedent is certain, preventing the party to the relevant agreement from withdrawing from the deal until such date.

2. Conditions subsequent

According to the Luxembourg Civil Code, conditions subsequent are future and uncertain events that lead to the termination of one or several obligations, or an entire agreement, when they occur.

Thus, when entered into, subject to one or several conditions subsequent, an agreement or obligation immediately exists and is immediately fully enforceable. However, in case of satisfaction/occurrence of the condition subsequent, such agreement or obligation (as applicable) automatically terminates with retroactive effect, putting the parties in the same situation as if they had never contracted. Conversely, when a condition subsequent does not occur within its satisfaction period or when it becomes certain that it will never be satisfied, the agreement or obligation continues to produce its intended effects and becomes final.

Conditions subsequent share the same uncertain character as conditions precedent. They share the same validity conditions, i.e., being possible to satisfy, being licit and not being prohibited by the law. Same as for conditions precedent, there are four main types of conditions subsequent: the ones depending

(a) exclusively from the hazard, the will of a third party or external conditions to the parties (conditions casuelles);

(b) on the one hand partially from the hazard, the will of a third party or external conditions to the parties and, on the other hand, partially from the will of one of the contracting parties (conditions mixtes or conditions potestatives or conditions simplement potestatives);

(c) from an event that all parties or one party can cause or prevent (condition potestative); and

(d) exclusively from the will of one of the contracting parties (conditions purement potestatives). However, the invalidity of conditions subsequent depending solely on the will of one of the parties (including the debtor) (conditions résolutoires purement potestatives) is debated [6].

CONDITIONS SUBSEQUENT DIFFER FROM TERMINATION CLAUSES (CONDITION RÉSOLUTOIRES TACITES OR PACTES COMMISSOIRES EXPRÈS) ESSENTIALLY BECAUSE THEIR EFFECTS OCCUR AUTOMATICALLY, WITHOUT ANY NEED FOR ACTION BY THE PARTIES OR ANY BREACH BY A PARTY OF ANY OF ITS OBLIGATIONS

Conditions subsequent differ from termination clauses (condition résolutoires tacites or pactes commissoires exprès) essentially because their effects occur automatically, without any need for action by the parties or any breach by a party of any of its obligations.

One could think at first sight that the use of conditions subsequent in share deal transactions is rare. This is only partially true. Indeed, while it is fair to consider that very few share deals are entered into subject conditions subsequent that would enable one of the parties thereto to terminate the agreement post-closing, conditions subsequent are sometimes used more discretely in share purchase agreements, for example, for implementing, in an alternative manner, a material adverse change clause or an automatic walk-away mechanism to the benefit of the purchaser or the seller in case of (material) inaccuracy of the representations and warranties between the signing date and the closing date [7].

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[6] As it does not prevent the obligation or agreement subject thereto coming into existence and the obligation or agreement will be enforceable until it is terminated.

[7] Even if they will be most frequently structured by using a termination clause (pacte commissoire exprès), which implies a fault from a party to be triggered.