



Conditions Precedent —

How to make sure you get what you bargained for

The rapid implosion of our economy has significant legal implications. Anyone who entered into a purchase agreement in the past year and has not closed on it will be revisiting it to see what rights if any there are to withdraw from the deal. Purchasers are just beginning to understand that they may have more to lose than their deposit.

The problems are manifested in prospective business transactions such as the offer by Ontario Teachers for BCE. The purchase agreement included, as a closing condition, that BCE must be solvent on closing. According to BCE's auditors, BCE did not meet the solvency test. This was an astonishing result both legally and practically as no one likely anticipated at the time the purchase agreement was signed that BCE might fail a solvency test.

Conditions precedent are typically those conditions which, if not fulfilled, would automatically cause the contract to be void or would permit the party who has the benefit of the condition to void the contract. There is a significant body of law on conditions precedent. Closing conditions are generally for the benefit of the purchaser and must be satisfied on closing for the purchaser to be obligated to close. There is less jurisprudence on closing conditions.

An important aspect of contracts generally, and particularly conditions precedent and closing conditions, is to allocate risk. Conditions precedent

allocate risk and, in certain cases require action, by a party to the agreement before primary obligations in the contract become enforceable. For example, a purchaser may have the benefit of a "subject to financing" condition. The purchaser may have an obligation to find financing but generally the financing condition is worded so broadly that both the purchaser and the vendor recognize if the purchaser does not get a satisfactory financing commitment, the purchaser will get his deposit back and the deal will be at an end. Careful wording is required to ensure this result. Other conditions may be in the hands of third parties such as rezoning. These are typically called true conditions precedent.

Once conditions precedent are either fulfilled or waived, the contract becomes enforceable. In more complex commercial transactions, the purchaser may insist on closing conditions which, if not satisfied, would allow the purchaser to refuse to close. An example of a closing condition is that representations and warranties made by the vendor when the contract was originally entered in to are true on closing. Often purchase agreements do not clearly and precisely address the legal consequences if a closing condition is not met, apart from the right of the purchaser to withdraw from the transaction and be repaid its deposit. Careful attention should be paid to the consequences if a closing condition is not satisfied, as the purchaser may have spent

considerable amounts of time and money for due diligence and preparing its organization to absorb the target only to find that the target does not satisfy the closing conditions when the time comes to complete.

In this regard, closing conditions represent an allocation of risk to the vendor and/or the purchaser for events which may occur between execution of the contract or waiver of the conditions precedent and the closing. Sometimes months can pass between signing of the contract or waiver of conditions and closing. Frequently extensions are requested and agreed upon by both vendor and purchaser without either reflecting on closing conditions or representations and warranties. However, during that time, economic and other conditions can change drastically; the purchaser may want to reconsider whether or not to close the deal and the rights he has to refuse to close and the vendor may want to revise the closing conditions to ensure that further delay will not adversely affect his rights to require the purchaser to close. We have certainly seen a dramatic turnaround in economic conditions from August 15th to November 1st, 2008 and we are likely to see litigation on many outstanding transactions.

Some conditions precedent and closing conditions are readily accepted by both vendor and purchaser in commercial transactions. Examples of these are financing, zoning, review of financial statements, review of operating statements, inspection of the assets, etc. The latter are typically referred to as "due diligence".

An example of a more problematic closing condition is a representation by the vendor that the financial

condition of the target is substantially the same on closing as set out in the financial statements and interim financial statements sometimes provided many months prior to the closing. Another problematic closing condition is that there has been no material change in laws or regulations pertaining to the business of the target from the date the contract was signed.

Extensive rights to withdraw from a transaction on closing are often found in underwriting agreements favoring the underwriter and loan agreements favoring the lender. One can expect these will continue to prevail under our current economic conditions.

It is apparent that certain conditions represent the effort by the purchaser to protect itself against the obligation to purchase an asset which has depreciated in value or is not what the purchaser expected when the contract was first signed. The vendor, on the other hand, will want to ensure that the purchaser will close regardless of any intervening events which are beyond the vendor's control.

The possibility of intervening events and allocation of risk and consequences of these events are very important considerations in contracts and merit full exploration before contracts are finalized. To address these issues, the client and the lawyer must communicate about the nature of the business of the client and the target to ensure the risks are understood and properly addressed in the contract.

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