Farnsworth on Contracts - Farnsworth and Wolfe, § 8.08, Pitfalls in Drafting Posed by Conditions

Farnsworth on Contracts - Farnsworth and Wolfe
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Importance of conditions to drafter

In the rules governing express conditions, the law is at its most draconian. Every drafter should keep this in mind in the client's interest. If the language of the contract makes an event a condition, there is no requirement that the event appear significant or that the choice of the event appear reasonable. With limited exceptions the parties have complete freedom of contract in this respect. [1] Nor is there a requirement that the failure of the event to occur be material. Instead of a rule of substantial compliance, a harsh rule of strict compliance generally prevails. [2] Furthermore, a promisor that makes a promise subject to a condition generally puts on the promisee the burden of pleading and proof of the occurrence of the condition. [3] Although not every drafter will have both the will and the power to take full advantage of these harsh rules, no drafter should be oblivious of them.

Four common pitfalls

Four common pitfalls are encountered, however, in drafting a provision that makes the occurrence of an event a condition of a promise. First, the provision may be read as imposing a duty that the event occur rather than as making the occurrence of the event a condition of a promise. Second, the provision may be read as one making the occurrence of the event merely a measure of the time for performance of the promise and not a condition of the promise. Third, the provision may not make clear what promise is made conditional on the event. Fourth, the provision may not adequately define the event. All of these pitfalls can be avoided by careful drafting.

1. Condition or duty?

The first pitfall results from the judicial preference for an interpretation that imposes on a party a duty to see that an event occurs, rather than one that makes the other party's duty conditional on the occurrence of the event. The drafter who intends that the duty be conditional should therefore make this intention clear. Failure to use such conventional language as “if” or “on condition that” courts disaster. [4] Even the use of the word “condition” before an enumeration of events invites the argument that the word is used to mean broadly “terms” rather than narrowly “conditions.” [5] It should not be overlooked that if one wants to have one's cake and eat it too, one can, in addition to making one's own duty conditional on the occurrence of the event, also impose on the other a duty to see that the event occurs. [6] And by making the occurrence of an event a condition of one's own duty in addition to imposing on the other a duty to see that the event occurs, one can have the benefit of a rule of strict rather than substantial performance. [7]

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2. Time or condition?

The second pitfall results from the judicial preference for an interpretation that the occurrence of the event is merely a measure of the time for performance of the promise and not a condition of the promise. [8] This preference is particularly strong where the rights of a subcontractor to payment by a contractor are involved. In that situation it may not be enough to avoid “when” in favor of “if” or “on condition that.” The prudent drafter will want to include more unambiguous language, such as “final payment is contingent upon payment to the contractor.” [9]

3. Condition of what promises?

The third pitfall—that of failing to make clear what promise is made conditional—is exemplified by the situation in which a transaction is subject to the obtaining of financing, to government approval, or to some similar event. Although it is usually intended that the promise of only one party—the purchaser in the common case of a sale of land—is subject to such a condition, it is possible for the promises of both parties to be so conditioned, and the drafter should leave no doubt as to what is intended. [10] Ambiguity on this point will invite dispute if, for example, the purchaser decides to go ahead with the transaction even though the event has not occurred, contending that the provision was for its sole benefit—a condition of the purchaser's promise only. [11]

4. What is event?

The fourth pitfall—that of failing adequately to define the event—is illustrated by the “satisfaction” cases. Where a party's promise to pay is conditional on that party's satisfaction with the other's performance, failure to make clear whether the satisfaction is to be “reasonable” or only “honest” invites dispute. [12] It will usually be in the promisor's interest to have the test one of honest, rather than reasonable, satisfaction, and even the promisee may see an advantage in such a test if the contract involves matters that are, for example, so subjective or so complex as to make it difficult for a trier of fact to apply a standard of reasonableness. [13] The drafter should keep in mind that courts are more willing to find that the standard is one of honest satisfaction if no forfeiture will result. [14] Similar considerations obtain in cases where the satisfaction of a third party, such as an architect or engineer, is made a condition, though in such situations courts are more willing to apply a test of honest satisfaction. [15] Where third-party approval is provided, the contract should make appropriate provision for the possible inability or refusal of the third party to make a decision. [16] The contract should also make clear whether the giving of the certificate is conclusive on the owner. [17]

Unconscionability and forfeiture

Even the draconian law of conditions is subject, in extreme cases, to exceptions based on unconscionability [18] and forfeiture. [19] As to these, the drafter can do little other than moderate any harshness of provision so as to avoid a claim of unconscionability and provide, by a severability clause or otherwise, for the consequence if the provision is denied effect.

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Anti-waiver clauses

A party may have a better chance to fend off a claim that a condition has been waived if the drafter has included an anti-waiver clause. Such clauses, typically stating that no action or inaction by the promisor shall amount to a waiver of any condition of the promise, while not always honored by courts (particularly if the language does not clearly apply), [19.1] have enough chance of success to merit consideration. [20]

The following sections to problems of nonperformance what we have learned in the preceding sections about the law of conditions.

Footnotes

1 See the discussion of the point that a condition need not be material in § 8.02 *supra.*

2 See the discussion of strict compliance in § 8.03 *supra.*

3 See the discussion of condition subsequent in § 8.02 *supra.*

4 And not just because unusual language may yield ambiguity. *See* Solar Applications Eng'g v. T.A. Operating Corp., 327 S.W.3d 104 (Tex. 2010) ("When no conditional language is used and another reasonable interpretation of the contract is possible, the terms will be construed as a covenant in order to avoid a forfeiture.") (internal quotes omitted).

For an instance of narrowly averted disaster, *see* Diesel Props S.r.l. v. Greystone Bus. Credit II, 631 F.3d 42 (2d Cir. 2011) (contract provided that agreement to pay would "only be applied to orders placed by [distributor] upon receipt of a purchase order for product"; distributor would provide copies of purchase orders to manufacturer and lender; manufacturer "agree[d] to provide [lender] with a copy of any invoice for its products delivered to [distributor]"; and the lender would be obligated to pay the manufacturer after the distributor supplied the lender with a copy of its invoice to a customer in the amount of the manufacturer's invoice; held unclear whether this created a condition or a promise, but parol evidence clarified that the requirement that purchase orders be supplied to the lender was a condition to the lender's payments to the manufacturer). The court here got to the right result, but in spite of drafting, not because of it. The various requirements that invoices be supplied were framed as promises to do something, exactly the opposite of what was likely intended. It would have been easy to reframe these requirements using the classic language of conditions—for example, "Lender will provide funds to manufacturer if/on condition that/provided that/subject to the following events …" Using the language of promise was dangerous, to say the least; it worked this time, but it is hard to see why one would choose to cross a river by a tightrope when a suspension bridge is next to it.

See the discussion of the preference for finding a duty in § 8.04 *supra.*

5 See the discussion of *condition* as a term or an event in § 8.02 *supra.*

6 See the discussion of the effect of a condition and a duty in § 8.03 *supra.*

7 Gadsden Bowling Center v. Frank, 31 So. 2d 648 (Ala. 1947) ("when performance [of a covenant] is made a condition precedent to extension" of a lease, "strict performance is required").

8 See the discussion of condition or time period in § 8.04 *supra.*

9 BMD Contractors v. Fid. & Deposit Co. 679 F.3d 643 (7th Cir. 2012) (giving effect to pay-if-paid provision: "It is expressly agreed that owner's acceptance of subcontractor's work and payment to the contractor for the subcontractor's work are conditions precedent to the subcontractor's right to payments by the contractor."; "Although it's possible to reinforce the clarity of a pay-if-paid clause by using redundant language—e.g., 'in agreeing to this condition precedent, subcontractor assumes the risk of owner's insolvency'—additional language like this is not necessary if the meaning of the condition precedent is clear"); Sloan & Co. v. Liberty Mut. Ins. Co., 653 F.3d 175 (3d Cir. 2011) (giving effect to pay-if-paid provision: "Final payment shall be made within thirty (30) days after the last of the following to occur, the occurrence of all of which shall be conditions

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precedent to such final payment"; among the named conditions were "[Owner] shall have accepted the Work and made final payment thereunder to [Contractor]" and "[Contractor] shall have received final payment from [Owner] for [Subcontractor's] Work."); FaulknerUSA, LP, v. Alaron Supply Co., 322 S.W.3d 357 (Tex. Civ. App. 2010) (giving effect to pay-if-paid clause; provision was captioned "condition precedent," first sentence stated that payment by the owner is a condition precedent to payment to the subcontractor, later portions state that "Subcontractor is entitled to payment only for that portion of the Subcontract Work for which [contractor] has been paid by Owner," "Subcontractor expressly assumes the risk of nonpayment by Owner," and "The Subcontract Amount includes compensation to Subcontractor for the assumption of this risk," and final sentence declared that "[t]his provision establishes a condition precedent, and it shall not be construed merely as a Time of Payment Clause.").

See the discussion of the example of a subcontractor in § 8.04 *supra.*

10 See the discussion of how conditions relate in § 8.03 *supra.*

11 *See* Jackson Hole Builders v. Piros, 654 P.2d 120 (Wyo. 1982) (condition that seller sell enough units to obtain interim financing did not obligate seller to terminate if enough units were not sold). *But see* Foster v. Lall, 516 N.Y.S.2d 570 (Sup. Ct. 1987) (provision allowing either party to cancel if purchaser could not obtain financing within 45 days was not for sole benefit of purchaser); Eastern Motor Inns v. Ricci, 565 A.2d 1265 (R.I. 1989) ("although the 'dropdead' provision was inserted at [purchaser's] request, it was included for the protection of both parties"). See generally the discussion of the example of financing in § 8.04 *supra.*

12 See the discussion of the nature of *satisfaction* in § 8.04 *supra.*

13 See the discussion of the significance of impracticality in § 8.04 *supra.*

14 See the discussion of the significance of forfeiture and enrichment in § 8.04 *supra.*

15 See the discussion of third-party satisfaction in § 8.04 *supra.*

16 See the discussion of impracticability as an excuse in § 8.07 *supra.*

17 The better view is that the certificate is not conclusive. Bickerstaff v. Frazier, 232 So. 2d 190 (Fla. App. 1970) ("architect's certificate of completion does not estop [owners] as a matter of law from claiming damages"). *Cf.* Thomas Crimmins Contracting Co. v. City of New York, 542 N.E.2d 1097 (N.Y. 1989) (though provision "empowers the chief engineer to make conclusive factual determinations concerning [specified] subjects" it "is not an explicit, unequivocal agreement for alternative dispute resolution"). For a case reaching a contrary conclusion as to a progress payment, *see* Hart & Son Hauling v. MacHaffie, 706 S.W.2d 586 (Mo. App. 1986) (when contract "provides for progress payments as the work proceeds, the architect's certification of payment is conclusive on the parties").

If it is desired that the certificate not be conclusive, the drafter should so provide. *See* Southern, School Bldgs. v. Loew Elec., 407 N.E.2d 240 (Ind. App. 1980) ("parties unequivocally indicated … that [architect's] certificate of approval was *not* to be conclusive" as to duty to make final payment); Burke County Pub. Schools v. Juno Constr. Corp., 273 S.E.2d 504 (N.C. App. 1981) (provision that excepted failure to comply with contract did not bar owner's claim). If the opposite result is desired, the drafter should make that clear. *See* United Pac. Ins. Co. v. County of Flathead, 499 F.2d 1235 (9th Cir. 1974) (certificate was conclusive where contract provided that "Architect/Engineer's … decisions shall be final and conclusive"); City of Granville v. Kovash, Inc., 118 N.W.2d 354 (N.D. 1962) (certificate of city's engineer was conclusive on city where contract so provided, "in the absence of … fraud, collusion, concealment …, or of such gross mistake as would imply bad faith"). The drafter should be careful lest the language inadvertently suggest this result. *See* H.M. Hughes Co. v. Sapphire Realty Co., 181 N.E.2d 405 (N.Y. 1962) ("where contract provides for 'final payment' upon issuance by the architects of a 'final certificate,'" certificate is conclusive). If it is desired that the certificate be conclusive as to some matters and not others, this should be made clear.

See generally 1 J. Sweet & J. Sweet, Construction Industry Contracts: Major AIA Documents § 5.23 (3d ed. 1996); UNCITRAL Legal Guide on Drawing up International Contracts for the Construction of Industrial Works 123–24 (1988).

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18 See the discussion of the point that a condition need not be material in § 8.02 *supra.*

19 See § 8.07 *supra.*

19.1 In Wsb Rehab. Servs. v. Central Accounting Sys., 2022-Ohio-2160, P33 (Ohio Ct. App. 2022), the contract provided that "waiver by either party of a breach or violation of any provision of this Agreement shall not operate as, or be construed to be a waiver of any subsequent breach of the same or other provision thereof." The contract also required submission of invoices with specified details prior to payment. The court concluded that the invoice requirement was a condition precedent and had been waived by payments over seven years despite invoices that did not conform to the requirements. It further held that the anti-waiver clause was not triggered because the performance waived a condition precedent, not a breach. Accordingly, the court "h[e]ld that Blue Sky's failure to perform the invoice requirement—a condition precedent—did not constitute a breach or violation of the agreements. The anti-waiver clause was limited to breaches or violations of the agreements. Because Blue Sky did not breach or violate the agreements, the anti-waiver clause was never triggered. The facilities defendants were obligated to continue paying Blue Sky for services it provided." *Id.* at P36.

20 Johnson v. Central Bank, 514 So. 2d 969 (Ala. 1987) (enforcing non-waiver clause in security agreement); Fageol Truck & Coach Co. v. Pacific Indem. Co., 117 P.2d 669 (Cal. 1941) (parties bound by provision that time was of essence and by anti-waiver clause); Van Bibber v. Norris, 419 N.E.2d 115 (Ind. 1981) (enforcing non-waiver clause in security agreement). Wis. Elec. Power v. Union Pac. R.R., 557 F.3d 504 (7th Cir. 2009) ("It is true that while nonwaiver clauses are no longer unenforceable, there is still some authority for treating them as themselves waivable. But if that notion were taken literally, no-waiver clauses would be worthless. Fortunately, it is not taken literally; the waiver of a no-waiver clause must be proved by clear and convincing evidence…) (citations omitted) (Posner, J.). For cases refusing to give effect to anti-waiver clauses, *see* Connecticut Fire Ins. Co. v. Fox, 361 F.2d 1 (10th Cir. 1966) ("non-waiver" agreement providing that insurer's investigation would not waive any conditions of policy did not prevent waiver of proof of loss requirement by adjuster on whose "apparent authority" insureds relied "to know what they must do to recover their loss"); Dillingham Commercial Co. v. Spears, 641 P.2d 1 (Alaska 1982) (in spite of non-waiver clause, landlord's "long acquiescence constituted a waiver of her right to claim a default for [tenant's] late payments of rent"); Formall, Inc. v. Community Nat'l Bank, 360 N.W.2d 902 (Mich. App. 1984) ("'anti-waiver' clause is itself subject to estoppel"). *Cf.* Westinghouse Credit Corp. v. Shelton, 645 F.2d 869 (10th Cir. 1981) (summary judgment precluded by question whether creditor waived "its right to strictly enforce the contract's terms, of which the 'anti-waiver' clause is one, by accepting [debtor's] late payments, a course of performance inconsistent with those terms"), followed in Exxon Corp. v. Crosby-Mississippi Resources, 40 F.3d 1474 (5th Cir. 1995) (rejecting attempts "to make much about the 'no waiver' provision").

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