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“SUBJECT TO”: PRE-CONDITION OR PERFORMANCE CONDITION, DOES IT MATTER?

In commodities trading, it is quite common to find an agreement expressed as being "subject to" something. Notable examples include "subject to contract" and "subject to obtaining a licence". In this briefing, we consider what these terms mean and what effect they have on the parties, their relationship and their obligations.

Pre-conditions and performance conditions

"Subjects" can be split into two types: pre-conditions and performance conditions.

Pre-conditions

Pre-conditions signal that the parties have not yet reached the stage of legal commitment; they prevent a binding contract from coming into existence and so parties are not under a contractual obligation to fulfil a pre-condition.

The words "subject to contract" are usually the most effective here because they create a strong presumption that the parties intend to be bound only once formal contracts have been exchanged. Other examples include "subject to details" and "subject to board approval."

Different words can be used but are only likely to have the same effect as "subject to contract" if they (and the circumstances) clearly show that the parties did not intend to be legally bound. For example, the English Courts have held that a provision recommending that a guarantor should seek legal advice before signing a guarantee was sufficient to indicate that the parties would only be bound when the guarantee was signed and not by an earlier oral agreement, even though the document did not contain the words "subject to contract."¹

Words should be used with care to avoid them inadvertently having an effect you did not intend. For example², the English Courts found that a contract had been made when one party forwarded a signed quotation and the other responded with an email titled "contract confirmation", which clearly confirmed acceptance of the offer. This was in spite of the signed quotation stating "*a formal contract will follow in due course*" as well as the acceptance email stating that a "*full contract [will be] sent for your signature and return*". The references to later formal/full contracts were deemed "*a mere expression of the desire of the parties as to the manner in which the transaction already agreed to, will in fact go through.*"

Performance conditions

In contrast to a pre-condition, a performance condition does not prevent a contract from coming into existence. Rather, it is contained within an existing contract and there is an implied obligation on the party responsible to take reasonable steps to fulfil it. If a performance condition is not satisfied (other than due to a breach of contract by one of the parties), the effect is that the parties will not be required to perform their respective obligations under the contract.

The distinction between pre-conditions and performance conditions is not always obvious. An important factor is whether the "subject" depends on the decision of a contracting party or on that of a third party. If it depends upon

¹ Investec Bank (UK) Ltd v Zulman and another [2010] EWCA Civ 536

² Immingham Store Co Ltd v Clear Plc [2011] EWCA Civ 89

the decision of a contracting party, it is likely to be a pre-condition. If it depends on the decision of a third party, it is likely to be a performance condition.

Examples of "subjects" which are likely to be performance conditions include circumstances where international sale of goods contracts are made subject to obtaining an export or import licence. Although one party will be responsible for seeking the licence, the outcome of the application will ultimately depend on decisions made by a third party. In contrast, pre-conditions such as "subject to contract", "subject to details" and "subject to board approval" involve performance which is at the discretion of the parties themselves.

HFW Comment

The use of "subjects" in commodities contracts is quite common but the distinction between whether a "subject" is a pre-condition or a performance condition can be difficult to determine. Such a distinction is significant, because a pre-condition means that no contract is formed and no obligations arise, whereas a performance condition is contained within an existing contract and imposes an obligation on the responsible party to take reasonable steps to fulfil the condition.

As so often, clarity is key. If you do not want to be legally bound by an agreement, the safest option is to use the expression "subject to contract" because its meaning is clear and well understood. It is also best to place these words in the title or description of the agreement rather than in the body of the text, so as to be clear that they apply to the whole document.

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