CONSTRUCTION - SWITZERLAND

Regulatory changes and *force majeure* – impact on lump-sum and build-operate contracts

November 13 2017 | Contributed by LALIVE

AUTHOR

Matthias Scherer

Introduction

Lump-sum contracts provide certainty to employers and financial backers regarding a project's financial risks. The risk of actual costs being higher than the agreed lump sum is on the contractor. However, in most legal systems and contracts the contractor will be entitled to additional remuneration in case of changes to the contract's scope which increase the costs of the works (variations) and events attributable to the employer. Nevertheless, the risk of cost being affected by unforeseen events which are attributable to neither the contractor nor employer is not always well addressed in contracts. New laws and regulatory interference in a project are among the events most feared by contractors and employers alike. The Federal Supreme Court has addressed such situations in various decisions.

Palestine casino case

A Liechtenstein company (contractor) entered into a contract with the Palestine Authority and a Palestine company (the employer) for the construction of a tourist resort including a hotel-cum-casino in West Jordan, Palestine. The employer was indirectly controlled by the Palestine Authority. The contract was governed by Swiss law and provided for arbitration in Switzerland. The contract and the casino concession contained various stabilisation clauses, including that "this Concession Decree shall not be revoked or altered by any authority by law or decree or similar measures bearing the same effect, in whole or in parts thereof".

Force majeure

The contract also contained a *force majeure* clause:

> "*The obligations of each party, other than the obligations to make payments of money as provided in the agreement, should be suspended while the party is prevented or hindered from complying, in whole or in part, by* force majeure*, including strikes, lock-outs, labour and civil disturbances, unavoidable accidents, laws, rules, regulations or orders of any government or national, municipal or other governmental agency, whether domestic or foreign, wars or conditions arising out of or attributable to war, or other matters beyond the reasonable control of the party*."

It was agreed that significant changes to the political or security status of the area could be invoked which would affect the economic situation of the project by preventing potential guests and patrons from visiting the facilities as a result of *force majeure*.

The hotel was built and remained in operation for a number of years until travel restrictions and

damage inflicted by the Israeli army resulted in its closure. In 2000 the parties entered into new agreements for the further development of the resort. However, the casino licence was subsequently not renewed based on the gambling prohibition in the Palestine Criminal Code. The contractor sued the Palestine Authority and the Palestine company, resulting in arbitration in Switzerland. The arbitral tribunal found that the contractor could not force the Palestine Authority to issue a licence in violation of its law and the decision was appealed to the Swiss Federal Supreme Court. It is unclear from the published decision whether the employer relied on the non-renewal of the casino licence as a case of *force majeure*, but it did argue that the contract was void for being illegal or impossible to perform. The contractor, on the other hand, argued that it was not void and that the Palestine Authority was estopped from relying on the gambling prohibition as it had signed the contract when the law was already in force, allowing the casino to remain in operation (*venire factum proprium*). In that respect, the contractor also relied on the stabilisation clause which should have prevented the Palestine Authority from altering the casino licence. The court did not consider that the finding that the Palestine Authority had belatedly enforced its own law was contrary to public policy (which is the threshold in an annulment case). The stabilisation clauses were of no help. Ultimately, the court set the award aside because the arbitral tribunal had not decided whether the hotel could be operated without the casino (4A_532/2016, May 30 2017).

Aborted district heating system case

For a flat fee a general contractor was tasked with the construction of a multi-story building with several individually owned flats. The contract provided that the lump sum was subject to:

> "*modifications due to* force majeure *or to circumstances not attributable to the general contractor as well as those resulting from new or modified legal or administrative requirements or their interpretation. Increases or decreases of the construction costs resulting from these modifications are borne by or credited to the employer, outside the agreed lump sum*. " (Translated from French.)

The building was supposed to be heated by a district heating system that the municipality was about to put in place. Therefore, beyond a small introduction tax the contract did not foresee costs for the construction of a heating system and heating equipment.

Subsequently, the municipality abandoned its plans, considering the district heating system not to be cost effective. The general contractor proposed another heating system to the employers (the future condominium owners) which was more expensive than the distant heating solution initially contemplated. The contractor rolled over the full costs of the new heating system minus the introduction tax. One of the employers did not accept the increase of the lump-sum price. The contractor took the view that all cost increases due to unforeseen events were recoverable pursuant to the above contract clause. The employer argued that a lump sum was by nature immutable. The parties submitted the dispute to an arbitrator which rejected both views. The arbitrator found that while the contractor could not reasonably expect to recover any and all costs due to unforeseen events short of *force majeure*, equally the employers could not consider the lump sum to be cast in stone. The arbitrator found that the change of heart of the municipality could not have been foreseen and therefore fell under Article 373(2) of the Code of Obligations, which provides that a tribunal can adjust a lump-sum price in the event of unforeseen or unforeseeable events. However, the arbitrator reduced the recoverable amount to approximately 60% of the actual cost.

The contractor challenged the decision before the Federal Supreme Court. The court found that the arbitrator had not erred in considering that the clause did not allow the contractor to recoup any costs simply because they stemmed from events which were not attributable to the contractor. The fact that the employers were not construction industry professionals was relevant. The court did not take issue with the calculation of the additional costs, or the finding that they were not fully recoverable. Indeed, the value increase of the new heating system from the employer's perspective was not equivalent to the total construction costs of the contractor. The contractor had to account for the costs which would have arisen in any event, namely the installation of a provisional heating system pending the introduction of the planned district heating system (Decision 4A_112/2014, April 28 2014)

Comment

Swiss courts and arbitrators under Swiss law will interpret any clause addressing unforeseen and *force majeure* circumstances seeking to establish the parties' actual intentions when entering into the clause. If they cannot be established from the text and surrounding circumstances and evidence (including drafts and witness statements), the tribunal will construe the clause objectively, regarding how it can be understood in good faith.

Under Swiss law, parties are free to draft bespoke *force majeure* clauses. In construction contracts, without such a clause, Article 373(2) of the Code of Obligations provides some comfort to contractors in the event of unforeseen events.

Regulatory changes have been found to be a valid excuse even if the regulator is party to the contract. However, this is not a finding that will apply in all circumstances. The court found no bad faith on the part of the regulator in this case. In different circumstances, the regulator may have been found to be estopped from relying on its own law as a cause of *force majeure.*

In the event of international construction projects the contractor will also want to analyse whether a regulatory change results in a violation of a bilateral investment treaty.

Regulatory changes may occur in the law applicable in the country of the project. Even if the parties to the contract agree on a different governing law, such changes may be relevant.

For further information on this topic please contact Matthias Scherer at Lalive by telephone (+41 58 105 2000) or email (mscherer@lalive.ch). The Lalive website can be accessed at www.lalive.ch.
