## Construction - Switzerland

### Court Considers Owner's Right to Substitute Contractors

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**Introduction**

Swiss law allows the creditor of an obligation to require performance of that obligation. If the creditor cannot obtain performance, it may be authorized to engage a substitute contractor to perform the obligation instead (Article 98 of the Swiss Code of Obligations). In construction contracts, the owner need not wait until completion or scheduled completion of the work. If defects in the work or other violations of the contract with the original contractor (including a delay in completion) are certain to occur, Article 366(2) of the code authorizes the owner to have the work completed by a substitute contractor at the cost and risk of the original contractor. Before doing so, the owner must put the original contractor on notice.

The Geneva Court of Appeal has now provided some clarification on the relationship between the contractor's right to interim measures of protection and the owner's right to substitute the contractor in case of defective performance or delay.

**Facts**

In a major building project in Geneva, the general contractor was in delay with the completion of the sophisticated building management system to monitor and control the building's air conditioning, lighting, fire detection and blinds. The owner put the contractor on notice and then announced that it would have the building management system completed by a substitute contractor. The contractor objected to the substitution.

It was undisputed that the work of the substitute contractor resulted in substantial changes, and that once the substitute work had been completed, the state of the work at the time of substitution could no longer be ascertained.

Before awarding the work to the substitution contractor, the owner performed an inspection of the incomplete building management system in the presence of the original contractor and had a status report prepared. The contractor objected to the substitution and requested an inspection by an independent expert. The owner denied this request.

The contractor applied to the Geneva courts requesting the appointment of an independent expert pursuant to Article 323 of the Geneva Code of Civil Procedure and, as an urgent interim measure, an order preventing the owner from proceeding with the completion of the building management system by a substitute contractor. The owner resisted the application, arguing in particular that such an inspection would delay the completion of the building management system by a matter of months, causing risk to the building's occupants and incurring further costs.

**Decision**

The order was first granted on an *ex parte* basis, but was subsequently lifted by the court of first instance. The court of appeals rejected the contractor's appeal and confirmed the denial of the order.

The Geneva court recalled that the owner's right to replace the contractor in the event of delay in completion did not require the prior authorization of the court.(1) The owner must be able to proceed expeditiously in such cases. Once the owner has decided that it wishes the delayed work to be performed by a substitute contractor, the original

contractor's obligation to perform the works is replaced by an obligation to pay the costs of the substitute works and to make an advance to these costs.

Analyzing the merits of the application, the court made the following considerations:

- The owner's right to substitute performance is regulated by Article 366(2) of the Code of Obligations, a provision of federal law.
- The request for appointment of an expert to establish a state of fact and a corresponding order to delay the substitution works until completion of the expert report was based on Article 323 of the Geneva Code on Civil Procedure, a cantonal enactment.(2)
- The right to substitution as a remedy under federal law prevails over the procedural remedies under cantonal law.

The court found that there was sufficient likelihood that the conditions permitting substitute performance had been met. Indeed, full proof is not required in the framework of summary proceedings for interim measures.

First, Article 366 of the Code of Obligations does not require that the entire works be defective: a single defect is sufficient to trigger the owner's right to substitute the contractor, provided that the defect is not insignificant. This point was confirmed by the Federal Supreme Court's Decision 4C 255/1996 of March 28 2000. In the present case, this point was not controversial since it was uncontested that the building management system had not been completed by the original contractor.

Second, the court had to decide on the controversial issue of whether the right to substitute requires fault on the part of the contractor. In the above-mentioned decision, the Supreme Court had left this question open. The Geneva court seems to have been of the view that it was sufficient that there was no fault on the part of the owner. It found that the contractor had not alleged any responsibility of the owner for the defectiveness of the building management system.

Third, the owner must have put the contractor on notice, inviting it to remedy the defects. No notice is required if it is manifest in light of the contractor's conduct that it would not perform in spite of a notice. The court found that due notice had been given.

Therefore, the requirements for a substitution of the contractor under Article 366(2) of the Code of Obligations were *prima facie* met. The owner was entitled to substitute the contractor and the contractor was not allowed to delay the substitution by the time required for the expert investigation. The court also pointed out that the burden of proof for the deficient state of the building management system rested with the owner. In the proceedings on the merits, which in this case had to be brought before an arbitral tribunal, the owner had to meet this burden.

**Comment**

This decision confirms the general requirements for the substitution of a contractor in case of delays or defects. According to Article 366(2) of the Code of Obligations, the owner must show with certainty that the works will be defective or delayed. It need not necessarily be shown that the contractor is at fault. The contractor must be put on notice and given the opportunity to put things right, unless it is clear that it is unwilling to do so or incapable of doing so. Where a substitution turns out to be unjustified, the original contractor may claim compensation.

Two other cases are relevant to this issue. The first case concerned remedial work after completion and the question of whether a contractor which is called upon to correct defects must be given the opportunity to inspect the work. In a decision of May 29 2006 (Decision 4C 91/2006), the Federal Supreme Court held that if the scope of the required corrective work is unclear, the contractor has the right to inspect the work in order to determine the necessary correction. If the owner refuses access to the site, the substitution may be wrongful. The court confirmed a decision of a lower court which had denied an owner's claim for substitution costs. The owner had invoked this claim for set-off against outstanding claims of the contractor. It held that the owner should have allowed the contractor to visit the construction site, to inspect the defects alleged in the owner's expert report and to comment on them. The contractor should have then been requested to remedy all defects that had been properly notified. The owner was not entitled to have such remedial works performed by a third party unless it was obvious that the original contractor was unwilling or unable to perform them. In the case before it, the court found no evidence that the contractor was incapable of performing the remedial works. Moreover, it was permissible for the contractor to insist on a site visit to examine the alleged defects prior to offering to perform the remedial works. Further, since the owner had not put the contractor on notice, requiring the correction of the defects in a specified time, the court also rejected the owner's argument that the contractor's offer to remedy the defects had come too late or that it was subject to unjustified conditions.

In the second case, decided less than a month later (Decision 4C 79/2006, June 22 2006) and involving similar (although not identical) facts, the Supreme Court decided in favour of the owner. The contractor argued that the owner had rejected its offer to remedy certain defects and had thus forfeited its right to have the contractor perform remedial works. The court (upholding a lower court's decision) held that since the contractor's offer had not been an unconditional and specific offer to remedy defects, but rather had been framed as a global solution, the owner, by rejecting the offer, had not forfeited its right to insist later that the contractor remedy the defects.

The statutory regime is not mandatory. The parties may agree that the only remedy available to the owner is to request the contractor to perform remedial work. If the contract includes language to this effect, the owner is not entitled to reduce the payment due to the contractor if the repair work is duly performed, as was shown in a Supreme Court decision of July 25 2006 involving a Swiss owner and an Italian contractor (Decision 4C 77/2006).

As Swiss law is often applied in projects outside Switzerland, these cases are of interest beyond the field of Swiss construction law, especially where the substance of the dispute is subject to Swiss law, even where foreign courts or arbitral tribunals have to decide on interim measures. Indeed, this case addresses interesting questions concerning the relationship between state courts and arbitral tribunals and between substantive and procedural rights. The two courts in Geneva made it clear that the substance of the dispute was reserved. They made a point of ensuring that the owner's substantive right to quick action in case of the contractor's default was not frustrated by procedural manoeuvres. Similar considerations will have to be borne in mind by arbitral tribunals applying Swiss law to the merits when faced with procedural applications which conflict with the rights and remedies under that law.

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**Endnotes**

(1) Geneva court of first instance, April 17 2008, Decision C/4297/2008-SP, not published.

(2) The 26 cantonal codes of civil procedure will be replaced by a single Federal Code of Civil Procedure on January 1 2011.