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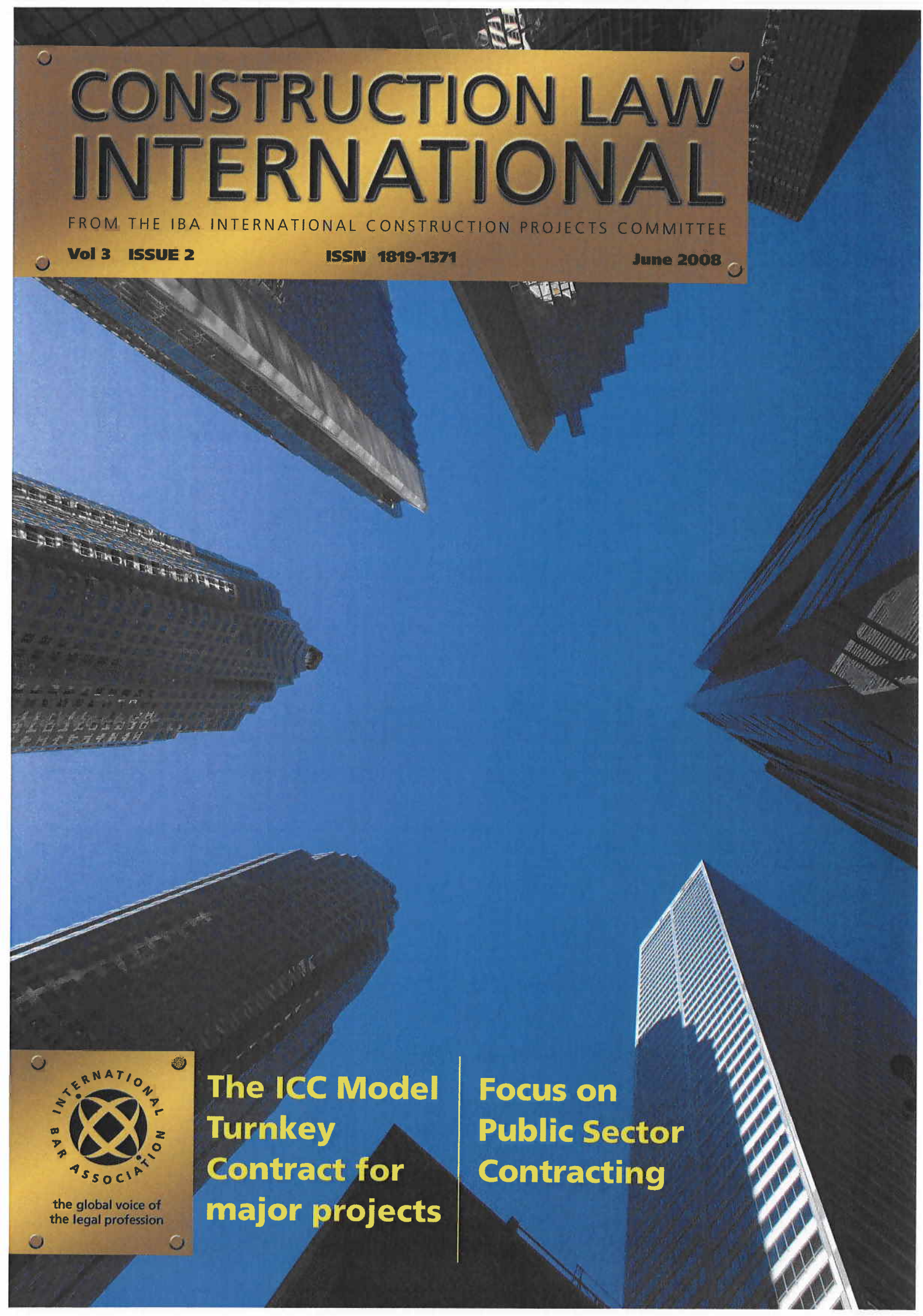

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The Court held that the first stage of the test to be applied to determine the existence of a duty of care is that of proximity, ie, that there be sufficient legal proximity between the claimant and defendant for a duty of care to arise. Proximity includes physical, circumstantial as well as causal proximity. The focus is on the closeness of the relationship between the parties themselves.

Assuming a positive answer to the preliminary question of factual foreseeability and the first stage of the legal proximity test, a prima facie duty of care arises. Policy considerations should then be applied to the factual matrix to determine whether or not to negate this duty. Relevant policy considerations would include the presence of a contractual matrix which has clearly defined the rights and liabilities of the parties, and the relative bargaining position of the parties.

The Court also held that the two stages are to be approached with reference to the facts of decided cases, although the absence of such cases is not an absolute bar against a finding of a duty.

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SWITZERLAND

Contract termination: rights and obligations of employers and contractors

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A recent Federal Supreme Court of Switzerland decision (Decision 4C.393/2006 of 27 April 2007) addresses some important questions regarding the rights and obligations of employers and contractors after the termination of a contract for works.

More specifically, the decision – which is also relevant to construction projects subject to Swiss law outside Switzerland – addresses:

- the distinction between termination for convenience and termination for good cause;
- the contractor's remedies in case of termination for convenience; and
- the contractor's duty to alert the employer to circumstances which may increase the cost of the work, including the employer's own acts and omissions.

Background

Under Article 377 of the Swiss Code of Obligations, an employer has the right to terminate a contract for convenience at any time before completion of the works, provided that it compensates the contractor. Article 377 provides that, 'as long as the works are not completed, the employer may withdraw from the contract against payment of the works already performed and against full compensation of the contractor'. The contractor must be put in the position it would have been in had the contract been fully performed, which includes compensation for lost profit.

Article 366 gives the employer the right to terminate the contract for cause without paying compensation in cases where it is clear that, due to no fault of the employer, the contractor will be unable to finish the works within the time frame agreed by the parties. Also, if it is clearly foreseeable that – through the contractor's fault – the works will not accord with the contract, the employer can specify a deadline by which the contractor must remedy these defects. If the contractor fails to do so, the employer can hire a third-party contractor for the repair works or the entire outstanding works, at the risk and cost of the original contractor. The employer is further entitled to terminate the contract and reject the finished works in case of severe defects (Article 368).

In the case at hand, the Supreme Court addressed the – so far undecided – question of whether, in the case of a termination of a contract for convenience pursuant to Article 377, the amount of compensation can be subject to equitable reductions. The Court found that it could, although only to a limited extent.

Facts

Completion of the works was delayed for reasons that proved controversial between the parties. The contractor maintained that the delays were due to the employer's repeated postponement of meetings and its unjustified failure to approve the way in which the works had been performed, which accorded with the specifications. For its part, the employer claimed that the works did not accord with the contract.

Dissatisfied with the contractor's work, the employer terminated the contract before completion of the works. The employer brought an action before the Geneva Court of First Instance, claiming reimbursement of its advance payment and seeking a declaration

that it was free from any obligations under the contract since the contractor had failed to deliver the works in accordance with the contract. The contractor introduced a counterclaim for payment of the outstanding amounts under the contract, and for compensation for its lost profit.

Decision

The lower courts squarely rejected the employer's claims in their entirety and ordered it to pay the outstanding amounts due to the contractor under the contract, as well as to compensate the contractor for its lost profit. The Supreme Court confirmed this decision.

The Supreme Court observed that the contract had been terminated at a time when completion of the works had not yet taken place. According to the Court, the deadline agreed for completion was ambitious, but not unrealistic. The Court further found that the works had not been defective. Consequently, Article 366 of the Code did not apply, since it allows for the termination of a contract only in case of delayed execution or where defects in the works were clearly foreseeable. Moreover, the employer had in any event not complied with the particular conditions set out by Article 366, such as setting the contractor a deadline by which to remedy (existing or foreseeable) defects.

On this basis, the Court found that the employer had terminated the contract for convenience pursuant to Article 377. Accordingly, it was bound to compensate the contractor in full. However, the Court went on to explain that if the conditions of Article 366 or 368 are not met but the termination was nevertheless made on the basis of a just cause or as a result of some contributory fault of the contractor, only partial compensation may be owed. The contractor's delay or its defective performance does not constitute grounds for such a reduction; in such case the employer would have to resort to termination under Article 366 and comply with its specific conditions. Rather, the 'just cause' for termination could be found only in some other reprehensible behaviour on the part of the contractor that, while not falling under Article 366, makes it unreasonable to expect the owner to continue the contract.

The Court found that such an element of just cause did exist. It considered a ten per cent reduction in the compensation equitable on the basis of Article 369, which provides that 'the employer shall lose the rights granted to it in the case of a defect of the work if it caused the defects himself either by giving directions concerning the execution contrary to the express objection of the contractor, or in any other way'. Here, the contractor had neglected to inform the employer that its failure to cooperate with regards to the manner in which the works were performed was jeopardising the project and the timely completion of the works. By failing properly to notify the employer of this fact, the contractor had exacerbated the employer's position, which justified a ten per cent reduction in the compensation due.

Comment

The Supreme Court decision is an important signpost for employers intending to terminate a contract for works governed by Swiss law. Employers and their counsel should carefully consider the legal basis on which they are terminating the contract and, where possible, ensure that they satisfy the conditions which justify a termination without any compensation being due to the contractor.

In particular, the following lessons should be drawn from the decision:

- Employers who are entitled to terminate the contract pursuant to a specific provision of the Code of Obligations – such as Article 366, which allows for termination in case of delay or non-performance – but who nevertheless terminate for convenience (Article 377) must compensate the contractor in full. Thus, employers who are faced with delays or defects caused by the contractor would be well advised to follow the requirements for termination set out in Article 366 and follow the Code of Obligations in order to preserve their rights.
- At the same time, the Supreme Court has held for the first time that employers who can show that a just cause other than those set out in Article 366 has led to termination of the contract may nevertheless benefit from a reduction in the amount of compensation due. However, such reduction will likely be limited in scope.
- The decision is further relevant with regard to the contractor's duty to object to instructions of the employer that are detrimental to the works. Unless the contractor notifies the employer unambiguously of the risks relating to these instructions, the employer may preserve its right to claim for delays or defects, even if they result from its own instructions.

That said, the provisions of the Code of Obligations that are at issue in this decision are not mandatory. Thus, the parties are free to agree on a different set of rules governing termination, such as those set out in subclauses 15.5 and 19.6 of the 1999 FIDIC Conditions of Contract for Construction for termination for convenience, and subclause 15.2 for termination for just cause. See also Michael E Schneider, Matthias Scherer, 'Switzerland', in Robert Knutson (ed), *FIDIC - An Analysis of International Construction Contracts* (Kluwer Law International, 2005).

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