

No contractor liability for defects visible at final inspection except concealed defects

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Introduction

Most legal systems and contract forms provide for notice requirements in case of defects of works. The nature of a defect is often an important factor. According to Article 370 of the Code of Obligations, defects that are visible at takeover are deemed to be accepted if the employer does not object. The most popular Swiss form provides the same in SIA 118, Article 163. Hidden defects must be notified immediately on discovery, unless the contract foresees a longer notice period. Defects that were fraudulently concealed by the contractor are not deemed to be accepted even if the employer takes over the works.

The interplay of these provisions was at the heart of a decision issued by the Supreme Court on March 8 2017 (4A_646/2016).

Supreme Court decision

A general contractor was tasked with building a new flight security centre at Zurich airport. Some time after the handover, the employer complained that the contractor had used non-contractual fittings, namely red brass (copper-tin-zinc alloy) instead of the better and more expensive stainless chromium steel fittings.

The contractor admitted that the original contract specifications provided for chromium steel but objected that the employer had accepted a contractor variation which allowed red brass. Red brass was therefore compliant with the contract. Even if the red brass had not become part of the contract, the employer was deemed to have accepted it, as it was visible on final inspection.

The employer argued that it had not accepted the contractor variation and that it could not reasonably be expected to have noticed at the final inspection that the fittings did not conform to the contractual specifications. The schedule of products had 380 pages and listed thousands of items. The employer's representative at the inspection could not have discovered all contract deviations. Moreover, there were several thousand fittings of all sizes in the buildings, but only 12 were visible and not in easily accessible places. Some of them were in areas where red brass fittings were actually allowed by the contract, such as water taps.

The lower court left open the question of whether the contractor's variation proposing red brass fittings had been accepted, which would have made the fittings contractual. Indeed, the court found that even on the employer's own case (red brass not being contractual), the right to object to red brass was forfeited as no reservations were made during final inspection despite the fittings being plainly visible.

The employer appealed to the Supreme Court on the grounds that the lower court had erred in finding that the defect was visible (and therefore needed to be notified immediately on final

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inspection). The Supreme Court confirmed the lower court decision, finding as follows:

- The inspection had been conducted thoroughly by a specialised service provider on the employer's behalf.
- The employer's representative was supposed to know the contract specifications, even if they were long and complex.
- The silver-coloured chromium fittings could easily be distinguished from the red brass alloy. That no chromium fittings were used was even more visible where the red brass fittings were next to water taps that were also in red brass. Moreover, red brass was common at the time that the building was erected and the employer's representative was familiar with red brass and its qualities.
- Even if only 12 fittings were visible, the employer's representative could not assume that all the other fittings were within the specifications. The contrary was true.
- The lower court did not err in finding that the red brass fittings had been visible and that they were thus not within the contractual specifications (as alleged by the employer). Consequently, the employer was deemed to have accepted the fittings.

As a last-ditch argument, the employer argued that even if the fittings were visible, their true nature had been concealed by the contractor. According to Article 370 of the Code of Obligations, defects that are concealed are not deemed to be accepted. The court noted that it was controversial among legal writers whether a visible defect could be concealed at all. Legal writers admitted this in the event that a contractor actively prevents the employer from discovering and notifying the defect (eg, by providing false information). As evidence for the alleged fraud, the employer pointed to two offers for additional works, which the contractor had provided after the main contract had been concluded. Both provided for chromium fittings. The employer therefore suspected that by its contract variation to the original contract, the contractor had secretly introduced the cheaper red brass fittings.

This argument had not been alleged in the lower court and could not therefore be raised before the Supreme Court.

Comment

Employers should keep a watchful eye on contractor variations and make sure that they do not modify any important quality or original requirements specified in the contract.

Whatever the length of the contract, the employer is duty bound to notify any deviation from the contract on final inspection. While this is correct as a principle, the courts or arbitral tribunals will also bear in mind the circumstances of each case. In the present case, the employer was represented by a professional and the defects were clearly visible (according to the court). In any event, in many contracts the employer may, for example, insist on a more employer-friendly regime allowing for defect notice during the entire guarantee period.

The courts will not protect a contractor which has fraudulently concealed a defect or prevented the employer from discovering a defect.

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