

Pricing unilateral change orders in lump-sum contracts

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Introduction

The Supreme Court (4A_125/2017, November 20 2017) recently addressed the issue of how a court (or arbitral tribunal) should determine the effect of a change order on a lump-sum contract price. The case focused on the interpretation of the complex wording of the most widely used standard form for domestic Swiss projects, the Swiss Institute of Architects' (SIA) Norm 118. But the court's decision also has wider ramifications for the interpretation of all construction contracts governed by Swiss law. It makes clear that tribunals should not lightly assume that a contract contains gaps regarding pricing. Rather, it must be assumed that the parties to a lump-sum contract intended to contractually regulate the effect on the contract price of a unilateral change order.

Background

The case dealt with a dispute over the amount of a contractor's additional compensation for several change orders issued by an employer pursuant to a lump-sum contract for the construction of 118 housing units.

On a literal reading, the contract, which incorporated SIA Norm 118, did not specify how the additional price should be calculated. As the Supreme Court noted, the relevant provisions of SIA Norm 118 appear to expressly contemplate only two scenarios, neither of which was applicable:

- where the parties fix the additional price by agreement; or
- where the employer expressly elects to have the works performed in accordance with a special contractual regime (*Regiearbeiten*) in which the contractor is compensated on the basis of the hours and materials required for the works.

The relevant provisions read as follows:

"Article 89 (Change order affecting works to be performed for a global or lump sum price)

1. When a change order has consequences for works that are to be performed for a global or lump-sum price, or on its conditions of performance, the parties shall agree on an increase or decrease of the price.

2. For works to be performed for a global price, the change in price is fixed on the basis of the [market costs on which the contractor based its original offer] (Article 62(2)), and for works to be performed for a lump sum price, on the basis of [these market costs] valid at the time of the change order.

AUTHORS

Matthias Scherer



Samuel Moss



3. If the parties cannot agree, Article 87(4) 4 applies.

[Note: The SIA Norm 118 distinguishes between a 'global price' (Globalpreis) and a 'lump-sum price' (Pauschalpreis). Both are in essence lump sums; however, the former may increase if there is an increase in market prices for salaries, materials and transport.]

Article 87 (Missing unit prices; modification of conditions of performance) [...]

4. If the parties are unable to reach agreement, the director of the works [the employer's representative] may elect to have the works performed in Regie or to entrust them to a third party, while indemnifying the contractor in full. If the works are of minor importance, they will always be performed in Regie." (Unofficial translation from original German/French.)

The Zurich Commercial Court concluded that this meant that there was a lacuna in the contract. It therefore resorted to the default rule for the determination of the price of a contract for works set out in Article 374 of the Code of Obligations, which refers to the actual costs of the contractor ("value of the work and the expenditures of the contractor"). It went on to reject the contractor's claim on the basis that it had not proved the value of the additional works that it performed.

However, the Supreme Court disagreed with the Zurich Commercial Court's reasoning and overturned its decision.

Supreme Court's reasoning

While the Supreme Court conceded that the wording of SIA Norm 118 was unhelpful, it took the position that a literal interpretation was "unconvincing". The court ruled that Article 89(2) of SIA Norm 118 cannot be understood to be relevant only to fixing the price for additional works by agreement, as the lower court had found. It held that pursuant to Articles 89(2) and 62, the price for the additional works should be calculated on the basis of the market rates for costs (eg, salaries, materials, transport and equipment) at the time the change order was issued.

According to the court, the parties would not have incorporated in their contract a right for the employer to issue unilateral change orders if the contractor could negate that right by obstructing any agreement on the additional price. Conversely, it could not have been the intention of the parties to force the contractor to implement change orders in the absence of an agreement on the additional price without regulating how the works should be priced.

Relevance of decision

The Supreme Court's decision is significant, as it is the first time that it has addressed the determination of the price for additional works in a lump-sum contract incorporating SIA Norm 118.

The court's reasoning is also relevant to the interpretation of other forms of lump-sum construction contract governed by Swiss law. The court clarified that it would not lightly find that a contract that allows an employer to issue unilateral change orders does not also govern their effect on the contract price. In other words, it should not be assumed that Article 374 of the Code of Obligations, the statutory provision that applies in the absence of a contractual arrangement on price, will apply to additional works.

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