

Construction - Switzerland

Remedies for contractor's refusal to repair defective works

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Background

Contracts for works are regulated by Articles 363 to 379 of the Swiss Code of Obligations. The interface between these specific provisions and those applicable to all contracts under the General Part of the code (ie, Articles 1 to 183) raises thorny issues, as was illustrated by a Federal Supreme Court decision of December 10 2010.⁽¹⁾ In that decision, the court had to deal with the remedies available to the owner in case of the contractor's default. Article 107(2) of the code provides, among other things, for a right to rescind the contract if the debtor fails to comply with its contractual duties even after having been granted an appropriate grace period.

The court confirmed that the right to rescind a contract for works is limited by the specific provisions applicable to that type of contract. Those specific provisions include a rule that, even where a contractor does not promptly repair defects, the owner can rescind the contract only if the works are so defective or deviate from the contractual terms to such an extent that the owner has no use for the works or cannot reasonably be expected to accept them (Article 368(1) of the code).

Facts

The case concerned a dispute regarding a purported 'sales contract' for a sailing yacht which the seller had the obligation to refurbish according to the purchaser's particular requests. The purchase price for the yacht amounted to Sfr70,000, of which only Sfr5,000 was paid for the purchase of the boat in its original condition; the remaining amount of Sfr65,000 was paid for its refurbishment. Due to further change requests by the purchaser, the cost of the refurbishment of the sailing yacht finally amounted to Sfr77,400, which the purchaser paid in full before the yacht was launched. However, the purchaser never formally accepted the sailing yacht.

Shortly after the launch, the purchaser identified several defects which the seller eventually rectified. Two months after the launch, the purchaser prepared a written list of additional defects which was subsequently replaced by further lists of defects prepared by an expert in the construction of sailing yachts. The purchaser gave the seller 20 days to rectify all defects. When the seller did not meet the deadline, the purchaser rescinded the sales contract and claimed the purchase price of Sfr77,400 in exchange for the return of the yacht. The seller refused and was sued by the purchaser before the cantonal court, which dismissed the claim. The purchaser appealed to the Supreme Court.

Supreme Court Decision

The Supreme Court characterised the purported 'sales contract' as a contract for works within the meaning of Article 363 of the code. It was undisputed by the parties that the sailing yacht was defective. In principle, Article 368 sets out the remedies available to an owner in the event of defects of a work. According to Article 368(1), if the works are defective or deviate from the contractual terms to such an extent that the owner has no use for them or cannot reasonably be expected to accept them, the owner may refuse to take over the works and, if the contractor is at fault, claim damages. In the case of minor defects or only slight deviations from the contractual terms, the owner cannot refuse to take over the works. In such cases the owner's only remedies are a price reduction in proportion to the decrease in the works' value or repair by the contractor at its own expense, as well as damages, provided that repair is possible without excessive cost

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to the contractor (Article 368(2)).

The problem in the case at hand was that the owner/purchaser had first opted for repair, but the seller had refused to remedy the defects. The provisions in the code which deal with contracts for works do not regulate how to proceed in such circumstances. Therefore, the general provisions of the code (Articles 102 and following) were applicable, including Article 107. Pursuant to Article 107(1), in case of the debtor's default, the creditor may demand specific performance within an appropriate grace period. Failing performance within such a grace period, the creditor may:

- claim damages in addition to specific performance;
- immediately waive performance and claim damages for non-performance; or
- rescind the contract.

The seller argued that rescission was subject to the limitation applicable to contracts for works under Article 368. Rescission was therefore possible only if the works were not fit for purpose or if the owner could not reasonably be expected to accept the works. On the other hand, the owner/purchaser took the view that, as a result of the contractor's refusal to repair the defects as he was required to do under Article 368, the provision was no longer applicable. As a result, according to the owner, the code's general provisions on default were triggered. Under Article 107(1), the owner argued that he had an unconditional right to rescind the contract.

The court accepted the contractor's view. It ruled that even if the conditions of Article 107 were met, the right to rescind contracts for works is governed exclusively by Article 368 (1). The contractor's refusal to remedy the defects of a work merely resuscitated the options available to the owner under Article 368 – to claim for a reduction in price and damages or, if the defects were sufficiently serious, rescission.

The court then assessed whether the conditions for rescission under Article 368 were met. The court also weighed the parties' interests, taking into account that the seller had, upon notice by the owner, already repaired half of the defects, and that the time limit of 20 days to repair the 30 additional defects was too short. Most importantly, the costs of the remaining remedial works were minor, according to the expert report (they were valued at approximately Sfr2,000), and none of the defects made the yacht unfit for its purpose or decreased its value substantially.

A final element considered by the court was the comparison between the market value of the yacht of Sfr25,000 and the amount of Sfr77,400 paid by the purchaser for its refurbishment according to his personal wishes. The court found that it would be inequitable to allow the owner to rescind the contract and return the custom-built sailing yacht to the contractor, given that he would be able to sell it only at a significant loss.

In consideration of all these circumstances, the court ruled that the conditions for rescission of the contract for works were not fulfilled in the case at hand.

Comment

It would be wrong to assume, on the basis of the type of works concerned (ie, the refurbishment of a yacht), that the decision in this case is a mere curiosity rather than a serious precedent. First, the decision confirms an earlier judgment of April 1 2010.⁽²⁾ Second, its findings are applicable to any contract for works. International contracts subject to Swiss law are legion, and many of them qualify as contracts for works. For instance, contracts for supply and (possibly) installation and construction of production lines, machinery and shipbuilding contracts⁽³⁾ qualify as contracts for works under Swiss law. If a contractor refuses to repair alleged defects, the owner's remedies will be assessed in light of the Supreme Court's reasoning in its decision of December 10 2010.

In summary, if a work is defective, in principle the owner to a contract for works has the following options according to Article 368:

- Where the defect is significant and acceptance cannot reasonably be expected, the owner may alternatively claim repair, price reduction or rescission of the contract.
- Where the defect is minor, the owner may claim only repair or price reduction.

The owner's choice of any one of these remedies is, in principle, binding and irrevocable. However, where the owner opts for repair and the contractor unduly refuses to repair the defects, the owner can again choose any of the remedies which were initially available to it. Rescission of the contract is one of these remedies, except in cases where the defects are considered to be minor.

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Endnotes

- (1) Decision 4A_290/2010.
- (2) Decision BGE 136 III 273.
- (3) A large number of shipbuilding contracts around the globe are governed by Swiss substantive law.

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