SWISS CONTRACT LAW

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Unilateral termination of a long-term IT contract: when is good cause not good enough?

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The existence of good cause denied in unilateral termination of a long-term IT contract, despite claims of outdated equipment, repeated technical issues and poor maintenance services.

Judgment of the Federal Supreme Court of 11 October 2021

Case Reference : 4A_573/2020, 4A_575/2020

Facts

In 2010, a company running a 5-star hotel in Geneva (the **Hotel**) and an IT company (the **IT Company**) entered into an 84-month-long contract (the **Contract**), relating to the provision of an IT system (the **IT System**) for in-room entertainment and information services (e.g. on-demand TV, video, music and internet access).

Under the Contract, the IT Company provided equipment (e.g. television screens), delivered software with user licenses, installed the equipment and software in the Hotel, and offered maintenance service in the form of a call center and on–site visits by technical staff. In return, the Hotel paid a fixed monthly sum of CHF 135 per room.

In 2013, the IT Company's call center was relocated to India. That same year, the IT System experienced its first major breakdown.

A second major breakdown occurred in May 2014. In a letter to the IT Company dated June 2014, the Hotel complained of the breakdowns as well as the relocation of the call center, which was now only available during office hours. The Hotel also claimed the technical equipment was outdated and too expensive, and demanded the IT Company disclose its financial investments in the Hotel.

In December 2014, the Hotel informed of its intention to terminate the contract, citing advances in technology and customer habits, which rendered the IT System less profitable. Contrary to the letter of June 2014, no mention was made of the technical problems experienced by the Hotel.

A third breakdown occurred in January 2015. The Hotel immediately informed the IT Company that it completely lost trust in their services.

Following over two months of fruitless negotiations, the Hotel terminated the contract for July 31, 2015 by letter dated April 10, 2015. It cited numerous technical malfunctions and the lack of responsiveness of the technical support staff, whose level of competence it deemed unsatisfactory.

The IT Company responded to the notice of termination by claiming the "*Early Termination Fee*" provided for in the Contract, which the Hotel paid in part, the remainder being claimed by the IT Company in debt enforcement and judicial proceedings.

Throughout the legal proceedings, the Hotel referred to a table listing 5,353 technical issues recorded over a period of four years. The problems and their importance were not always specified. Moreover, the IT Company claimed to have issued only 388 tickets during this period (of which 110 concerned the same room) and disputed the relevance and severity of the remaining issues. It namely claimed that the majority of the listed issues were not technical in nature but arose in cases where the hotel guests did not know how to use the IT System and its equipment (e.g. remote controls, cables, etc.).

Issue

For the purposes of this commentary, the key issue dealt with by the Federal Supreme Court was whether the grounds raised by the Hotel for terminating the Contract constituted good cause and therefore justified termination.

Decision

To begin with, the Federal Supreme Court briefly examined **the legal qualification of the Contract**. It held that the notion of "IT contract" refers in fact to the underlying technology and can thus encompass a large array of services. In the case at hand, it found that the parties were bound by a long-term contract of a mixed nature, insofar as it included elements of a lease, a license agreement, a contract for work and services, and a maintenance contract.

Next, the Federal Supreme Court had to determine whether the grounds raised by the Hotel for terminating the Contract constituted good cause.

It recalled that **the right of immediate termination for good cause** flows from a general principle applicable to long-term contracts and that it forms an exception to the principle of contractual loyalty. A party may terminate for good cause only where – due to a change in circumstances – it can no longer be required to pursue the contract until its term, whether this is due to a serious breach of contract or repeated breaches committed despite notices/warnings.

In the present case, the Federal Supreme Court **denied the existence of good cause** on the following grounds:

- First, it held that the technical problems relating to the IT System **did not exceed what was tolerable in the performance of a long-term contract of such nature**. Moreover, it was held that the Hotel had **failed to properly document** and to demonstrate the severity of the technical issues that it relied upon as the primary ground for termination.
- Second, despite the technical issues raised by the Hotel, **the *real* reason for termination was deemed to be economic in nature**. This finding relied on exchanges between the parties, in which the Hotel complained that the equipment was outdated and too expensive, and that the IT System had become less profitable due to advances in technology and customer habits. In this regard, the Federal Supreme Court noted that (i) the IT Company was not to be held liable for the change in habits of the Hotel customers; and (ii) in entering into a long-term contract, **the parties had accepted the risk that the equipment supplied could become outdated**.
- Finally, the previous instance also found that **the Hotel had failed to terminate *without delay***, as required by the relevant case law, but had instead (i) endured the maintenance and technical issues for several years; (ii) let several months lapse after the last major breakdown before resorting to termination; and (iii) terminated without immediate effect (i.e. termination announced in April for the end of July). Furthermore, the fact that the parties held negotiations from January to March showed that the current Contract was not in fact intolerable for the Hotel, subject to certain adjustments. These latter points seem not to have been challenged before the Federal Supreme Court, who abstained from commenting thereon.

Ultimately, the Federal Supreme Court **denied the existence of good cause** and held that the Hotel must pay the "*Early Termination Fee*" provided for in the Contract (i.e. a fixed sum multiplied by the number of months remaining until the expiry of the initial term of the Contract). Indeed, it held that while the parties did not explicitly provide for this fee to be due in case of termination *without* good cause, the relevant contract provision (entitled "*Consequences of termination*") must be **interpreted coherently** so as to also cover this scenario.

Key takeaway

Swiss case law has developed stringent rules governing termination for good cause, which the party terminating must abide by if it wishes to avoid paying damages (or a contractual fee/penalty). As regards IT contracts in particular, parties should endeavor to properly document all technical issues and to react appropriately (and quickly) in order to safeguard their right to immediate termination. Moreover, absent specific contractual mechanisms (some of which are briefly discussed below), the assessment of the level of service provided, of the technical issues encountered and of the outdated nature of the equipment supplied will be left to the discretion of the courts.

Comments

This decision calls for two key comments:

(1) First, as regards the reasoning of the Federal Supreme Court, it is worth noting that the General Terms applicable to the Contract provided for the possibility of early termination in the event of a "*material breach*" of the Contract. Curiously, however, neither the previous instances, nor the Federal Supreme Court, seemed willing to examine whether any such "*material breach*" had been committed in the case at hand. Instead, the grounds for termination were examined exclusively in light of the notion of good cause and of its requirements under Swiss case law.

It is also worth noting that while the Federal Supreme Court denied the existence of good cause, it did not explicitly examine whether this affected the *efficacy* of the termination itself. In other words, did the notice of termination – which proved unjustified – still effectively trigger termination? This issue is the subject of much uncertainty (and even controversy) for innominate contracts. In the case at hand, the courts derived the effects of the unjustified termination exclusively from an interpretation of the Contract, which was in fact silent on the issue. This begs the question of whether contract interpretation alone was enough or whether the application by analogy of other provisions of the Swiss Code of Obligations (such as art. 264 of the Swiss Code of Obligations [SCO]) should have stepped in to fill the gap in the Contract and to reach the result achieved in this case – a result that is otherwise to be saluted.

(2) Second, the courts have looked past the apparent reasons invoked by the Hotel (i.e. repeated technical issues and unsatisfactory maintenance services) and identified the *true* ground for termination as being economic in nature (i.e. potential loss of profits due to outdated equipment). In essence, the terminating party wanted an out from a long-term commitment that proved to be less profitable than expected.

From a practical perspective, this case shows that clients relying on outsourced technological solutions for their business should be cautious when entering into long-term commitments. Due to rapid technological advances and evolving customer preferences, long-term IT contracts may expose the client to risks of outdated software and/or equipment.

One way to address this issue is through Update/Upgrade Clauses, which allow the client to ensure that the technology supplied is up-to-date and competitive (whether it's at no additional cost or for a separate fee). The parties may also add a benchmark mechanism, allowing them to periodically assess (namely with the help of a third party) the level of service provided and to compare the quality and price offered to those of other providers on the market.

Furthermore, parties to an IT contract may wish to incorporate a Service Level Agreement (SLA), in which they may specify the level of service that the service provider must meet and set a service performance level below which the client may be entitled to terminate the contract. In doing so, the parties may also define certain services as essential (e.g. a Help Desk or Call Center service with 8/5, 24/5 or 24/7 availability). Depending on the agreed level of service, the restriction, outsourcing or relocation of these maintenance services may be deemed a breach of the agreement.

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