Does Broadening Permitted Land Uses Constitute 'Rezoning' under Swiss Law?

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In this decision, the Swiss Federal Supreme Court ruled that a broadening of permitted land uses qualified as *"rezoning"* under an earn-out clause in a property sale. As the parties had not defined the term, the Court interpreted the clause in light of the "Vertrauensprinzip" and adopting a broad understanding of "rezoning", based on the contract's context and purpose. The earn-out clause was triggered, and the buyer was ordered to pay the additional price. The case highlights the importance of precisely drafting earn-out provisions tied to zoning changes.

Judgment of the Federal Supreme Court of 17 November 2023

Case Reference : 4A_247/2023

Facts

B. (the "Seller"), a cooperative company, had operated a clinic for multiple years. After the clinic ceased operations in 2004, the Seller sought to sell the two plots of land the clinic occupied (the "Property"). The Property was primarily located in a "thermal exploitation zone"[1] according to spatial planning laws, restricting its use mainly to high-altitude clinics and sanatorium operations.

Under a real estate property purchase agreement dated May 10, 2007 (the "Agreement"), the Seller sold the Property to A. (the "Buyer") for a total price of CHF 12.51 million. The Agreement included a "purchase price increase" clause stating that "*Should that part of plot no. xxx, plan zzz, which is currently located in the thermal exploitation zone, be rezoned and sold in whole or in substantial part after the signing of this agreement, the buyer is obliged to pay the seller 60% of the difference between its sale price less (pro rata) investments (planning, construction, interest), property gains and transfer taxes) and the (pro rata) initial value. The parties agree on an initial value of CHF 3.3 million for the entire part located in the clinic zone. This provision shall apply for a period of 10 years from the signing of this agreement. The buyer is obliged to allow the seller to inspect the purchase agreements it has concluded.*"[2]

On July 7, 2009, the commune in which the Property was located modified its spatial planning law and expanded the permitted uses of terrains located in the thermal exploitation zone. On June 12, 2012, the Buyer sold the Property for CHF 15.8 million. Upon learning of this sale, the Seller asked the Buyer to inspect the purchase agreement, but the latter refused to comply.

On February 29, 2016, the Seller filed a complaint before the Court of First Instance, asking that the Buyer be ordered to pay CHF 5,071,807.72 plus 5% interest as of September 25, 2015. In its ruling of September 20, 2018, the Court of First Instance ordered the Buyer to pay the Seller CHF 4,436,131.70 plus interest. On March 30, 2023, the Cantonal Court dismissed the Buyer's appeal against this decision. It ordered the Buyer to pay the Seller CHF 4,634,912.43 plus interest, partially upholding the Seller's joint appeal.

The Buyer challenged this ruling before the Federal Supreme Court.

Issue

The central issue that the Federal Supreme Court had to address was whether the Property had undergone "rezoning", thus triggering the purchase price increase clause.

This required interpreting the contract to determine the meaning of the term "rezoning" as used in the Agreement.

Decision

The Cantonal Court found no evidence that the parties had agreed on a specific definition of "rezoning". Neither party had demonstrated that, at the time of the Agreement, it was clear between them that an expansion of the use of the thermal exploitation zone would constitute rezoning. Hence, the Federal Supreme Court applied art. 18 para. 1 of the Swiss Code of Obligations [SCO], interpreting the clause in accordance with the principle of trust.

The Federal Supreme Court noted that the notion of "rezoning" is not used uniformly and lacks any clear definition in

spatial planning law. Therefore, the only way to interpret the clause was by considering the context in which the Agreement had been signed.

In October of 2004, shortly before the Agreement was signed, the X. plot of the Property had undergone rezoning from a thermal exploitation zone to urban residential zone, substantially increasing its value. The person responsible for the sale on behalf of the Seller stated that the Seller wished to benefit from any future increase in value should the Property later be used for purposes other than a clinic.

Despite this example being relevant to the parties, according to the Cantonal Court, a change from a thermal exploitation zone to a urban residential zone was not the only possibility that the parties could envision for a value adjustment. Shortly before the Agreement was signed, the commune had informed the parties that the thermal exploitation zone was under review, and that its potential uses might be expanded in the future. The Federal Supreme Court upheld this reasoning and considered that this scenario must have existed in the parties' minds when the Agreement was concluded.

The Federal Supreme Court agreed with the Cantonal Court that the term "rezoning" should be interpreted broadly to include any change in land-use regulations that significantly increased the Property's value, including a broadening of permitted uses in the thermal exploitation zone. Consequently, the Property had undergone rezoning as defined by the Agreement, triggering the purchase price clause. The Buyer's appeal was dismissed.

Key take-aways

When interpreting the meaning of a disputed contractual term, the parties' motives for including an earn-out clause are key to understanding their intended meaning.

The party agreeing to pay an earn-out is best advised to precisely define the circumstances under which such earn-out shall be due, otherwise it risks a broader interpretation based on the common meaning of the term and the contractual context at the time of the conclusion.

Comment

Provisions whereby the parties decide to adjust the sale price at a later date are relatively common in practice. These so-called "earn-out" clauses allow the parties to account for anticipated but unpredictable developments at the time of contracting.

In real estate transactions, the impact of public law legislation on the valuation of a property is significant. An asset may lose all of its value if it is removed from a buildable area following a revision of the zoning plan. Conversely, its value may rise substantially when spatial planning law or building regulations suddenly allow for higher density (generally referred to as "Aufzonung") or broader uses (usually designated as "Umzonung"), or if it changes from a non-buildable to a buildable area ("Einzonung"). In this case, the parties had referred to a term that they had not precisely defined between themselves, which led both parties to dispute its interpretation, particularly the circumstances under which such an "Umzonung" would entitle the Seller to an earn-out.

The Federal Supreme Court confirmed its case law on the interpretation of the parties' intent. To this end, it relied significantly on the context in which the contract was concluded and the facts preceding the sale. The Court concluded that the parties had intended to involve the Seller in an increase in the value of the land resulting from a land-use measure. Such approach aligns with the Federal Supreme Court's established practice of examining various ways to ascertain the parties' true intentions. In its judgment, the Court dismissed purely linguistic arguments and instead focused on the factors that had led the parties to conclude the contract with an earn-out clause, namely the foreseeable revision of the planning framework , which could provide to better opportunities for the use of the property sold. In this context, it deemed it irrelevant that the parties had not specified what they meant by "Umzonung," as it was clear they intended to share the benefits arising from a change in the land-use rules, which were foreseeable or at least hoped for at the time.

This outcome aligns with recent case law in public law matters concerning changes in zoning (Um- and Aufzonung) in relation to value-increase tax (1C_233/2021), where both terms are to be understood as referring to situations that lead to an increase in value giving rise to taxation.

Other sources presenting the case

Hubert Stöckli, Grundstückkaufvertrag – Urteilbesprechung 4A_247/2023, in: BR/DC 03/2024 | p. 131.

David Graf / Dario Galli / Markus Vischer, Auslegung einer Earn out-Klausel, in:

dRSK, publiziert am 04. September 2024.

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[1] In German: "*Kurbetriebszone*".

[2] The relevant contract excerpt reads as follow in the original German version: "*Sollte derjenige Teil des Grundstücks Nr. xxx, Plan zzz, der heute in der Klinikzone liegt, nach Unterzeichnung dieses Vertrages umgezont und ganz oder zu einem wesentlichen Teil veräussert werden, ist die Käuferschaft verpflichtet, der Verkäuferschaft 60% der Differenz zwischen ihrem Verkaufspreis abzüglich (anteiliger) Investitionen (Planung, Bau, Zins), Grundstückgewinn- und Handänderungssteuern) und dem (anteiligen) Ausgangswert zu bezahlen. Als Ausgangswert vereinbaren die Parteien CHF 3.3 Millionen für den ganzen in der Klinikzone liegenden Teil. Diese Bestimmung gilt für die Dauer von 10 Jahren ab Unterzeichnung dieses Vertrages. Die Käuferschaft ist verpflichtet, der Verkäuferschaft Einsicht in die von ihr abgeschlossenen Veräusserungsverträge zu gewähren.*"

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