Can a long-term subcontract for mail management services be terminated if the main contract is terminated?

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The subcontract for mail management services at issue is an innominate contract that consequently cannot be terminated before the end of its term without just cause.

Judgment of the Federal Supreme Court of 20 December 2022
Case Reference: 4A_490/2021

Facts

C. SA ("C.") had outsourced its internal mail and courier service to A. SA ("A."). A. subsequently subcontracted the performance of the services to its subcontractor Z. SA ("Z.") through a service contract ("the Contract"). In essence, Z. had to handle any incoming mail and distribute it throughout C., as well as collect and process any outgoing mail.

The term of the Contract was set to five years ("the Term"). Less than two months after the beginning of the Contract, A. asked to reduce the Term to two years, however, Z. refused.

One year after the beginning of the Contract, A. terminated the Contract, arguing that its client C. itself (allegedly) terminated its relationship with it following an internal reorganization. A. saw this as a cause for termination of the Contract, despite the satisfactory performance of the Contract by Z.. The latter objected and filed a claim with the lower courts.

Both the First Instance Court and the Cantonal Court upheld the claim brought forward by Z.. They both considered that A. and Z. were legally bound by a 5-year contract for work and services, which did not allow for early termination, except for cause. As the (alleged) reorganization of C. was not considered a valid cause – A. could and should have added a specific provision to this effect in the Contract, linking its fate with the contract with C., but did not do so – Z. was entitled to positive damages, i.e. compensation for the lost profits due to the untimely termination.

A. filed an appeal with the Federal Supreme Court.

Issue

The Federal Supreme Court had to determine how the Contract should be characterized, and whether A. was within its right to terminate the Contract before the expiry of the Term.

Decision

A. claimed the contract was to be characterized as a Simple Agency Contract (governed by Art. 394 et seq. SCO) or a Contract of Carriage (Art. 440 et seq. SCO), which allow for immediate termination without indemnification.

A Simple Agency Contract can be terminated at any point in time (Art. 404 SCO), a rule that the Federal Supreme Court deems mandatory, despite criticism from some scholars. Indemnification for termination is due only if it occurs "at an inopportune juncture" (Art. 404(2) SCO). A Contract of Carriage applies the same rules (Art. 440 para. 2 SCO).

In order to characterize the Contract, the Cantonal Court and the Federal Supreme Court reviewed the obligations of the parties. In the case at hand, the parties had agreed upon a certain level of service – in particular, Z. had an obligation of result (where at least 95% of mail had to be processed in a timely manner), which is not compatible with a Simple Agency Contract, based on an obligation of means. The existence of an obligation of confidentiality and a relationship based on trust is not itself sufficient to consider that the Contract was a Simple Agency Contract, given that other contracts can also rely on a relationship of trust.

Regarding the carriage aspect, the fact that Z. had to “carry” C.’s mail on-site or from the site to the post office is not sufficient to characterize the Contract as a Contract of Carriage. In fact, the scope of the obligations was much broader, and the price was set as a flat rate rather than per volume of mail.

In conclusion, the Contract was characterized as an innominate contract, including some aspects of a Contract for Work and Services (Art. 363 SCO), but not of a Simple Agency Contract nor a Contract of Carriage. Thus, A. cannot validly rely on Art. 404 SCO to terminate the Contract.

Alternatively, A. claimed it was entitled to terminate the contract due to the internal reorganization of C.. A Contract for Works and Services can be terminated “where completion of the work is rendered impossible” (Art. 378 SCO) and, a as general rule, an impossibility of performance extinguishes the obligation (Art. 119 SCO).

A. alleged that the reorganisation of C. rendered it impossible to carry out the Contract. This point was challenged by Z. during the proceedings. A. could not claim that Z. had accepted the existence of the alleged impossibility, nor was it able to prove it, despite bearing the burden of proof. On these grounds, the Cantonal Court and the Federal Supreme Court considered that there was no cause to justify the termination of the Contract and, therefore, that Z. was entitled to damages.

In conclusion, the Federal Supreme Court rejected the appeal and confirmed the decision of the Cantonal Court.

Key takeaway

The characterization of a contract has a direct effect on the conditions surrounding the termination of said contract. Swiss law provides that parties to a Simple Agency Contract (and related contracts) are entitled to immediately terminate the contract without cause. However, given that the characterization of the contract is not left to the free determination of the parties but rather depends on the content of the contract itself, one should not simply rely on the title given to the contract. Indeed, where the parties have agreed upon an obligation of result, the application of the rules of the Simple Agency Contract may be set aside, and in the absence of a specific provision on the matter, the parties may not be able to terminate the contract without risking a claim for damages.

Comments

This decision illustrates the difference between the economic and legal standpoints of chains of contracts (in this case the main contract entered between the final client and its service provider and the subcontract between the service provider and the subcontractor). From a purely economic standpoint, C., A., and Z. are all involved in the same process. However, from a legal standpoint and given the doctrine of privity of contact as applied in Switzerland, the termination of the main contract between C. and A. has no direct effect on the subcontract between A. and Z.. Therefore, the termination of the main contract does not constitute a just cause for termination of the subcontract and does not make the performance of the obligations under the subcontract subsequently impossible within the meaning of Art. 119 SCO.

A. might have overlooked the risk related to termination by C. on its other contract. When drafting a subcontract, one should thus make sure to reserve the same termination rights or to unequivocally link the termination of the main contract to the subcontract.