Contract management: the risks of not reacting to annotations made by the other party at the time of signing of the contract

MALAK AHMADOV-EL ADDAL, JACQUES DE WERRA

Company found contractually liable for the act of an employee as a result of a handwritten statement made by the other party on the contract.

Judgment of the Federal Supreme Court of 10 July 2020
Case Reference : 4A_562/2019

Facts

A general contractor (the Principal) subcontracted a part of the construction work it has been entrusted with to another company (the Third Party).

When the Third Party's director signed the contract for work and services, he added a handwritten statement (the Handwritten Statement) stating that an employee of the Principal called F. (Employee F.) was authorized to sign for the Principal, i.e. for its employer (original text [in German]: "*Hr. F. ist unterschriftberechtigt für den Bauherrn + GU* [which stands for *Generalunternehmer*]", translation: "Sir F. is authorized to sign for the building contractor + the general contractor"). The Principal, who had already signed the contract, received a copy of the contract countersigned by the Third Party with the Handwritten Statement and did not object nor react the Handwritten Statement.

Employee F. monitored and coordinated the construction work, and acted as primary contact of the Principal to the Third Party. The Principal did not object that the construction work be managed by Employee F. Later on, Employee F. declared that he was unsure as to whether he had the authority to sign on behalf of the Principal.

Once the construction work had been carried out by the Third Party, Employee F. signed off on the work and sent the final statement to the Third Party for signature (with the amount due by the Principal to the Third Party). On the same day Employee F. sent the final statement to the Third Party, the Principal terminated the agreement with Employee F. (which was not disclosed to the Third Party). A couple of months later, the Principal claimed that Employee F. had not been authorized to legally act and submit documents on its behalf. When the Third Party sent the invoice to the Principal, the latter only paid half of the amount requested.

The Third Party claimed payment of the outstanding amount by the Principal. Both the court of first instance and the cantonal court of appeal in the canton of Valais ruled in favor of the Third Party. The Principal appealed to the Federal Supreme Court.

The Principal argued that at the time it had signed the contract, the Handwritten Statement made by the Third Party stating that Employee F. was authorized to sign for the Principal had not yet been added. As a result, the Principal had not granted Employee F. the authority to act on its behalf. The Principal also invoked a breach of Art. 33 para. 3 of the Swiss Code of Obligations [SCO], stating that the Third Party had acted in bad faith by not informing the Principal of the Handwritten Statement which had been added to the contract.

Issue

The Federal Supreme Court had to determine whether the Principal was bound by the acts of Employee F. towards the Third Party since it would have given the impression that it had granted to Employee F. the authority to act on its behalf.

Decision

The Federal Supreme Court set the legal framework on agency rules (Art. 32 ff. SCO) by recalling the three situations in

which a person (the represented person) may be bound by the rights and obligations arising from a contract made on its behalf by another person (the agent):

- If the represented person had granted the agent the required authority to act on its behalf ("*internal* relationship") (32 para. 1 SCO which provides that "[t]he rights and obligations arising from a contract made by an agent in the name of another person accrue to the person represented, and not to the agent");
- In the absence of authority conferred by the represented person to the agent, if the third party could infer the existence of such authority from the behavior of the represented person ("*external* relationship") (33 para. 3 SCO which provides that "[w]here a principal grants such authority to a third party and informs the latter thereof, the scope of the authority conferred on the third party is determined according to the wording of the communication made to him");
- In the absence of authority conferred by the represented person to the agent, if the represented person has ratified the contract (38 para. 1 SCO which provides that "[w]here a person without authority enters into a contract on behalf of a third party, rights and obligations do not accrue to the latter unless he ratifies the contract").

In the first case (see 1) above), the Federal Supreme Court underlined that Art. 32 para. 1 SCO requires a power of attorney conferred by the represented person to the agent (so-called *internal* power of attorney). From that perspective, the Handwritten Statement could not have been regarded as an *internal* communication of authority that would have been made by the Principal to Employee F. Therefore, the question of whether or not the contract had been signed by the Principal's director before or after the addition of the Handwritten Statement was deemed irrelevant. Moreover, given that Employee F. was unsure as to whether he had the authority to sign on behalf of the Principal, the Federal Supreme Court considered that Employee F. had not been granted the required authority to act on behalf of the Principal, and therefore excluded the application of Art. 32 para. 1 SCO.

With regards to the second case (see 2) above), the Federal Supreme Court recalled that, even in the absence of authority conferred to the agent, the represented person may nevertheless be bound if it has communicated to the third party the existence of a power of attorney in favor of the agent (see Art. 33 para. 3 SCO, so-called *external* power of attorney). The Federal Supreme Court pointed out that such communication may be implied and may be inferred from the behavior of the represented person if such behavior leads the third party to think that the person has granted authority to another person. What is decisive is whether the behavior of the represented person can objectively be understood in good faith as being a communication to the third party of powers, irrespective of the subjective perception or willingness of the represented person. Art. 33 para. 3 SCO further requires the third party's good faith (which is legally presumed to exist pursuant to Art. 3 para. 2 of the Swiss Civil Code [SCC]).

In this case, due to the Principal's lack of reaction to the Handwritten Statement (i.e. the Principal did not challenge the statement of the Third Party according to which Employee F. had the power to act for the Principal) and the day-to-day management by Employee F., the Federal Supreme Court considered that the Third Party could validly believe that the Principal had granted a power of attorney in favor of Employee F. It also held that the Principal failed to prove that the Third Party had acted in bad faith. The fact that the Principal had terminated the agreement with Employee F. on the same date that Employee F. had sent the final account to the Third Party was dismissed (given that the Third Party had not been informed about this).

In conclusion, the Federal Supreme Court found that, in accordance with Art. 33 para. 3 SCO, the Principal was bound by the Handwritten Statement added in the contract by the director of the Third Party and that, as a result, it was obliged to settle the final invoice corresponding to the amount that Employee F. had notified to the Third Party.

Key takeaway

As a general rule, an act of representation (a relationship of agency) is not valid in the absence of authority conferred by the represented person (the principal) to the agent. Swiss law, however, provides for an exception to this principle when the behavior of the principal leads the other party to think that the principal has granted authority to another person (such as an employee) to act on its behalf (Art. 33 para. 3 SCO). Art. 33 para. 3 SCO provides in this respect that "[w]here a principal grants such authority to a third party and informs the latter thereof, the scope of the authority conferred on the third party is determined according to the wording of the communication made to him". Art. 33 para. 3 SCO consequently presupposes that the principal communicates this to the third party, whereby "the scope of the authority conferred on the third party is determined according to the wording of the communication made to him". Based on its wording, this provision presupposes a communication made *to* the third party. What is interesting in this judgment handed down by the

Swiss Federal Supreme Court is that the power of representation was admitted on the basis of a communication that was not made *to* the third party but rather *by* the third party (i.e. the Handwritten Statement). The good faith of the Third Party in believing that the Employee F. had the power to act for the Principal was upheld because of the Handwritten Statement that was added on the contract by the Third Party at the time of signing of the contract. This constitutes a very broad application of Art. 33 para. 3 SCO.

In the context of commercial contracts, especially between corporate entities, many individuals may intervene in the process (whether during negotiations or for the purpose of performing the contractual obligations). Therefore, companies must stay alert and pay careful attention to the content of the contractual documentation and to the management of contracts – particularly in the process of signing the contract. This case law serves as a lesson of contractual diligence during the conclusion of a contract. By not reacting to a handwritten statement made by the other party on the signature page of the contract, the company was held liable for the acts of one of its employees to which it had not given a power of representation. Companies must consequently be aware of the risks of giving the impression that they would have granted a power of attorney to one of their employees.

In terms of contractual risk management, a response to a handwritten statement added to a contract when signing the contract implies a diligent contract management process. As the number of contracts in business transactions continue to grow, companies can no longer shove a contract signed in a drawer: it is imperative to manage and avoid risks (such as the risk of an unwanted power of representation) by identifying and keeping an eye on any potential last-minute amendment to a contract. In an era of growing automation of (AI-based) contract management and even contract conclusion mechanisms, one can wonder whether a totally automatic (i.e. without any human oversight) contract management system, in which the contract in question in this case would have been automatically digitally registered and stored by the Principal, would have identified the potential legal risk resulting from the addition of the Handwritten Statement that was made by the Third Party.

Comments

This judgement is a case book illustration of the reasoning that the Swiss Federal Supreme Court adopts in order to analyze whether there is a relationship of agency: is the represented person bound by the acts of the agent as a result of an *internal* power of attorney (Art. 32 para. 1 SCO)? If not and alternatively, is it bound as a result of an *external* "apparent" power of attorney (Art. 33 para. 3 SCO)? Or lastly because of a ratification of the contract by the represented person (Art. 38 para. 1 SCO)?

Quite interestingly, this case gives a concrete example of an agency which does not result from an active and direct "communication" of the powers that would have been made by the represented person. In this case, the agency results rather from the silence and thus from a lack of response from the represented person to the addition of a handwritten statement made by the third party at the time of signing the contract. Although silence does not generally mean acceptance, the detailed reasoning of the Federal Supreme Court reveals in this case the necessity for the represented person (i.e. the Principal) to respond in order to avoid giving the impression of a relationship of agency.

The case also outlines the key distinction between the *internal* power of attorney pursuant to Art. 32 para. 1 SCO and the so-called *external* power of attorney pursuant to Art. 33 para. 3 SCO. While the former generally derives from a unilateral communication of authority by the represented person to the agent, the latter, on the contrary, depends on the behavior of the represented person (in this case the Principal) which leads the third party (in this case the Third Party) to believe, in good faith, that a power of attorney was granted by the represented person to the agent.

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