Real estate development and silent partnership: appearances may not always be deceiving

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Unlike in a simple partnership, the silent partner in a silent partnership is not liable for a debt incurred by the general partner under a work contract with a contractor in a real estate development project.

Judgment of the Federal Supreme Court of 5 June 2024
Case Reference : 4A_342/2023

Facts

This matter, which arose from the non-payment for electrical work related to a real estate development project, can be summarized as follows:

In 2011, two promoters joined forces to build a chalet and a wellness center on two plots of land. The first promoter (the "Promoter 1") was the owner of these two properties and the holder of the real estate development account used to pay the companies involved in the construction. He was also the sole shareholder, director and employee of a public limited company (the "Promoter 1's Company") referred to in the minutes of the meetings concerning the construction.

The second promoter, a Belgian national (the "Promoter 2" and, together with the "Promoter 1", the "Promoters"), subsequently became the owner of the two plots of land in question after purchasing them from the Promoter 1 in 2012 and 2014 respectively, once the construction work had been completed. From 2010 onwards, either directly or through a limited liability company of which he was the sole shareholder and manager (the "Promoter 2's Company"), he made payments into the real estate development account that was used to pay the companies working on the construction site. The Promoters agreed that the Promoter 2's Company would be a 50% partner with the Promoter 1 in the real estate development and would provide all of its business contacts and technical expertise to the project.

The electrical works for the buildings constructed on the two plots of land were contracted by the Promoter 1 to Company A (the "Contractor"). The Promoter 2 knew the manager and employees of the Contractor, as the latter had previously performed electrical work on his apartment. Both the Promoters took part in discussions with the Contractor regarding the scope of the work to be carried out during which the Promoter 2 conveyed his preferences. No written contract was drafted for the electrical work; only an oral work agreement existed.

Electrical work started at the end of June 2011. During the construction process, the Promoter 2 provided specific instructions and requests regarding the execution of the work, which were taken into account by the Contractor. The Promoter 2, alone, chose the lighting fixtures for the chalet; while the lighting fixtures for the wellness center were chosen jointly by the Promoters. The Promoter 2 was not mentioned in any of the documentation relating to the development of the property, and the Promoters never disclosed any connection between themselves to third parties, at least not to the Contractor nor its employees. Payment delays were acknowledged by the Promoter 1, who also requested extensions for payment deadlines. There is no evidence that the Promoter 2 granted the Promoter 1 a power of attorney.

The Contractor issued its two final invoices dated November 30, 2013 to the architect. The Promoter 1 indicated that the portion of the work relating to the Promoter 2's apartment should be billed directly to the Promoter 2. The Promoter 2 paid the corresponding amount directly. However, the remaining invoices from the Contractor remained unpaid. According to the Contractor, the Promoter 1 told the Contractor on several occasions that he would settle the balance once he had received payment from the Promoter 2. As of December 30, 2013, the outstanding balance on the Contractor's invoices amounted to CHF 219,218, plus interest. The Contractor was not informed of the property sales that took place in 2012 and 2014.

The Contractor initiated legal proceedings for payment against the Promoter 1 and the Promoter 1's Company as well as the Promoter 2. During the course of the proceedings, the Promoter 1's Company was declared bankrupt, resulting in the severance of the case with respect to that entity. The Contractor argued that it had carried out the work for the Promoters, who, it claimed, constituted a simple partnership. The Court of first instance ruled in favor of the Contractor and ordered the Promoters, jointly and severally, to pay the outstanding invoices with interest.

The Promoter 2 appealed the judgment handed down by the first instance court. The Promoter 1 filed a joint appeal. The Valais Cantonal court overturned the decision of the first instance court and released the Promoter 2 from all liability, holding only the Promoter 1 liable to pay the Contractor the sum of CHF 219,218 plus interest. Applying the principle of transparency and subjective interpretation, the Cantonal court found that the Promoter 1 was the Contractor's contracting party. Furthermore, based on an objective interpretation, the court concluded that the Contractor could not, in good faith, have believed that the Promoters formed a simple partnership and were jointly its contracting parties.

The Contractor subsequently filed a civil appeal with the Federal Supreme Court seeking to have both Promoters held jointly and severally liable for the amount of CHF 219,218 plus interest.

The Federal Supreme Court dismissed the appeal.

Issue

Under procedural law, the Federal Supreme Court first had to assess whether the Contractor had a protectable interest in the annulment or the modification of the cantonal decision (see art. 76 para. 1 lit. b of the Federal Supreme Court Act [FSCA]), since the cantonal decision had already confirmed the Promoter 1's obligation to pay the outstanding balance of the Contractor's invoices.

On the merits, the Federal Supreme Court had to determine whether the Promoter 2 was liable for the outstanding balance of the Contractor's invoices and whether the Promoters could be held jointly and severally liable under the legal provisions governing simple partnership agreements (see art. 544 para. 3 of the Swiss Code of Obligations [SCO]).

Decision

In analyzing the admissibility of the appeal, the Federal Supreme Court recalled the rules on joint and several liability (art. 143 et seq. SCO) and on joinder of proceedings (art. 70 et seq. of the Swiss Civil Code of Procedure [SCCP]).

Joint and several liability is a matter of substantive law (art. 143 et seq. SCO) and must be distinguished from joinder of proceedings, which can be either voluntary (art. 71 SCCP) or mandatory (art. 70 SCCP), and falls under procedural law. Members of a simple partnership (art. 530 et seq. SCO) form a civil law community with regards to the assets (art. 544 para. 1 SCO) and are required to act jointly in all claims related to the assets of the simple partnership (active joinder). The partners are jointly and severally liable for partnership debts (art. 544 para. 3 SCO) and the creditor may choose to initiate a procedure against one, several or all partners. When a creditor takes action against several or all partners, i.e. against joint debtors, they are treated as voluntary joint defendants (passive joinder). Claims against voluntary joint defendants are independent of each other (even if they are joined under the same claim), meaning the court issues as many judgments as there are codefendants. It follows that, in order to secure his right to a joint and several condemnation, the plaintiff may have a legitimate interest in taking action against the release of one or more of the voluntary codefendants since only those who are convicted are jointly and severally liable. In this case, the Federal Supreme Court found that the Contractor had a valid interest in challenging the release of the Promoter 2 (see art. 76 para. 1 lit. b FSCA), since he had lost his case against the Promoter 2 in the second instance court and his right to the joint and several conviction of the Promoters. The Federal Supreme Court therefore rejected the plea of inadmissibility raised by the Promoter 2.

Turning to the merits of the case, the Federal Supreme Court first recalled the general principles for interpreting expressions of intention, which determine whether a contract has been concluded, who were the parties to the contract, and what were its terms (art. 18 para. 1 and art. 19 para. 1 SCO). The interpretation process follows two stages. First, the court must determine the parties' true and common intention (art. 18 para. 1 SCO), which corresponds to the subjective will of the parties. This interpretation is a matter of fact. As a court of law, the Federal Supreme Court is in principle bound by the lower court's factual findings (art. 105 para. 1 FSCA), unless they are arbitrary (see art. 9 of the Federal Constitution of the Swiss Confederation) or established in violation of the law (art. 105 para. 2 FSCA). In assessing subjective intent, the court considers the parties' statements and conduct, the circumstances before, during and after the conclusion of the contract, as well as their behavior following the conclusion of the contract.

If the true and common intention of the parties cannot be established or no agreement is found, the court proceeds to an objective interpretation. This involves examining the parties' statements and behaviors in accordance with the principle of trust (*principe de la confiance*; *Vertrauensprinzip*) to determine what a reasonable person would have understood under the circumstances (art. 1 para. 1 SCO in conjunction with art. 2 para. 1 of the Swiss Civil Code [SCC]). This interpretation is a question of law. In its analysis, the court considers the statements and behaviors of the parties, as well as the

circumstances preceding and surrounding the conclusion of the contract. The court does not take into consideration circumstances following the conclusion of the contract as they were unknown to the parties at that time. Consequently, when the court considers post-contractual circumstantial evidence, such as the parties' subsequent conduct, the court determines the parties' true and common intention, a finding that is a matter of fact and not of law, and is, in principle, binding on the Federal Supreme Court (art. 105 FSCA).

The Federal Supreme Court then examined whether the Promoters had formed a simple partnership, as claimed by the Contractor, or another type of partnership. It recalled the general principles applicable to simple partnerships. According to art. 530 para. 1 SCO, a simple partnership is a contract by which two or more persons agree to combine their efforts or resources to achieve a common goal. Such an agreement is subject to the general rules governing the conclusion of contracts. It is characterized by two key elements: (i) the contribution that each partner must provide for the benefit of the company (e.g. money, materials, claims or labor; see art. 531 para. 1 SCO); and (ii) the common purpose (*animus societatis*). The legal existence of a simple partnership does not depend on how the parties themselves define the relationship, and no formal requirements apply to its creation.

The Federal Supreme Court further clarified the distinction between internal and external relations within a simple partnership. With regard to relations between partners (i.e. internal relations), art. 543 para. 3 SCO protects the partner entrusted with the management authority of the simple partnership in the trust placed in them by their partners who authorized them to represent the simple partnership vis-à-vis third parties. When it comes to relations with third parties (i.e. external relations), art. 544 para. 3 SCO makes the partners jointly and severally liable for the commitments they have made vis-à-vis third parties, either jointly or through a representative. The joint and several liability provided for in art. 544 para. 3 SCO arises not only where a simple partnership is proven to exist, but also where a third party, acting in good faith, reasonably relies on the appearances of such a partnership based on the principle of effective appearance (*principe de l'apparence efficace*; *Rechtsschein*). However, such reliance is only protected if the conduct of the alleged partners clearly indicates participation in such a partnership.

The Federal Supreme Court then drew a distinction between a simple partnership and a silent partnership (*société tacite*; *stille Gesellschaft*), which is a special form of business association. A silent partnership is characterized by the participation of one or more individuals – the silent partner(s) – in financial or legal activities of another person – the general partner – without being visible to third parties. While a communal element exists internally, it is intentionally concealed in external dealings.

Internally, the silent partner and the general partner are bound by the *animus societatis*, the will to combine their efforts or resources to achieve a common goal. Externally, however, the silent partnership does not exist. The general partner is the sole owner of the real rights to the company's assets, including ownership of the silent partner's contributions, and they conduct business in their own name and on their own behalf. The silent partner does not represent the partnership and explicitly chooses not to be bound by it. Consequently, art. 543 paras. 2 and 3 SCO is not applicable, and the silent partner is not liable for the business's debts to third parties under art. 544 para. 3 SCO. Only the general partner bears such liability. According to established case law, a third party entering a business transaction with a silent partner cannot hold the latter liable for debts, even if the silent partner was involved in the negotiations that led to the conclusion of the contract so long as the third party is aware that the silent partner intends to remain in the background. However, this changes if the silent partner presents themselves externally as a partner and actively engages with the third party.

The Federal Supreme Court then considered whether, on the basis of binding circumstantial evidence, the Promoters should be deemed to have concluded a simple partnership or a silent partnership. It recognized that the Promoters were internally bound by a simple partnership agreement for a real estate development project involving the construction of a chalet and wellness center. The two plots of land had been acquired for this project. The Promoter 2's Company, which was solely controlled by the Promoter 2, was a 50% partner of the Promoter 1 in the real estate development project and provided it with its business contacts and technical expertise. The Promoter 2 and the Promoter 2's Company made significant payments to a bank account held in the Promoter 1's name.

However, the Federal Supreme Court pointed out that the internal existence of a simple partnership does not automatically imply its recognition by third parties. In this case, the Federal Supreme Court held that the existence of a partnership between the Promoters had not been demonstrated externally, particularly not to the Contractor. The Promoters failed to establish the existence of a simple partnership in a way that the Contractor would have had to accept under the principle of good faith or the principle of effective appearance. The Promoter 1 was the sole owner of the plots of land and the sole holder of the development account at the time the contract with the Contractor was concluded. The work was

commissioned by the Promoter 1. The name of the Promoter 2 was never mentioned in any of the documentation related to the project, nor in any of the site reports. Furthermore, the Promoter 1 repeatedly told the Contractor that he would settle the invoices once he had been paid by the Promoter 2 and instructed that the electrical work on the Promoter 2's apartment should be invoiced directly to him. That work was, in fact, paid directly by the Promoter 2, which supports the argument that the two contracts were separate. In addition, the subsequent sale of the properties to the Promoter 2 in 2012 and 2014 respectively was never disclosed to the Contractor. At no point in time did the Promoters disclose any partnership relationship to third parties, at least not to the Contractor's directors nor its employees. The Contractor knew that the Promoter 2, being a wealthy foreign national, was prohibited from acting as a promoter in this case under the Federal Act on the Acquisition of Immovable Property in Switzerland by Foreign Non-Residents (ANRA) until he had obtained a residence permit in Switzerland. According to the Federal Supreme Court, the fact that the Promoter 2 had given instructions to the Contractor during the course of the work did not change the legal nature of their relationship. In fact, the requests and other interventions by the Promoter 2 occurred largely after the oral conclusion of the work contract between the Contractor and the Promoter 1. There was no evidence to suggest that the Promoters had agreed to modify or assign that initial contract.

Thus, the Federal Supreme Court concluded that the relationship between the Promoter 1 and the Promoter 2 constituted a silent partnership, with the Promoter 1 acting as a general partner and the Promoter 2 as a silent partner. Since art. 544 para. 3 SCO does not apply to such partnerships, the Federal Supreme Court dismissed the appeal by substitution of reasons.

Key Takeaway

First, this decision is a reminder of the principles of joint and several liability as well as the principles of joinder. Members of a simple partnership form a legal entity (art. 544 para. 1 SCO), and must sue together as mandatory partners (art. 70 SCCP) for the assets and claims of the simple partnership. With regard to liabilities, however, the partners are jointly and severally liable as simple partners (art. 71 SCCP) for the partnership's debts (art. 143 et seq. SCO). While joint and several liability is governed by substantive law, joinder is a procedural concept that ultimately depends on substantive law.

Second, this decision illustrates the distinction between the subjective and the objective methods of contract interpretation. When interpreting a contract, the court first seeks to determine the true and common intention of the parties (art. 18 para. 1 SCO), taking into account the statements and behaviors of the parties as well as the circumstances before, during and after the conclusion of the contract. This assessment is a point of fact. Failing that, the court applies objective interpretation based on the parties' statements and behaviors, as well as the circumstances before and during the conclusion of the contract, but not afterwards. This is a point of law.

Third, this decision underscores the boundaries between a simple partnership and a silent partnership. While the partners in a silent and simple partnership share the *animus societatis* in their internal relations, the partnerships differ significantly in the way in which they act towards third parties. In their relations with third parties, the partners in a simple partnership are jointly and severally liable for the partnership's debts. A silent partnership, on the other hand, is purely internal and its existence is not visible to third parties. Only the general partner is visible to third parties, and art. 543 paras. 2 and 3 SCO do not apply. The general partner alone is liable for the partnership's debts, and art. 544 para. 3 SCO does not apply – unless the silent partner goes beyond their reserve and openly engages with the third party as a partner. In this case, the conduct of the silent partner effectively transforms the silent partnership into a simple partnership, and the third party is protected by the trust in the appearance thus created. The silent partner is then jointly and severally liable for the debts of the partnership (art. 544 para. 3 SCO).

Comment

The Federal Supreme Court's decision not to recognize the joint and several liability of the Promoter 2 vis-à-vis the Contractor is convincing. It upholds the good faith principle (art. 2 para. 1 SCC), as the circumstantial evidence did not support the conclusion that the Promoter 2 had acted outside of his role and improperly evaded the joint and several liability that would have applied, had a simple partnership been recognized vis-à-vis third parties.

More generally, this case is a reminder that simple and silent partnership agreements are governed by the general rules on the conclusion of contracts and, consequently, by the general rules of contract interpretation. Neither type of partnership agreement is subject to specific formal requirements; accordingly, they may be concluded orally or inferred from conclusive acts.

This case also highlights the fact that a silent partnership is a special form of company and is not explicitly regulated in the SCO. The rules governing simple partnerships apply by analogy to silent partnerships, subject to certain reservations, some of which are essential. Simple partnerships and silent partnerships are both characterized by a contribution from the partners and a common purpose. However, the specific characteristics of the silent partnership require a different set of rules than those applicable to the simple partnership in its dealings with third parties, in order to take into account the inherently secret nature of this type of partnership.

Unlike simple partnerships, silent partnerships do not exist in the eyes of third parties. The general partner acts in their own name and on their own behalf when dealing with third parties. The relations between partners in a silent partnership are therefore *res inter alios acta* from the point of view of third parties, since they have no apparent and, *a fortiori*, no legal existence vis-à-vis third parties. The silent partner is therefore not jointly and severally liable with the general partner for the partnership's debts. However, a silent partner who manifestly oversteps their background role cannot invoke the protection of the silent partnership against third parties in order to avoid joint and several (and unlimited) liability. In such a case, the third party's trust is protected by the appearance thus created, and the silent partner who loses this capacity becomes jointly and severally (and without limitation) liable to the third party (art. 544 para. 3 SCO). This corrective mechanism is a concrete expression of the prohibition of abuse of rights (art. 2 para. 2 SCC).

Last but not least, it is interesting to note that the Federal Supreme Court recalled, by way of *obiter dictum*, that the Contractor could have requested the registration of a statutory mortgage in his favor (art. 837 para. 1 no. 3 and 839 et seq. SCC), which he did not do. The statutory mortgage for craftsmen and contractors is a real estate lien that secures payment for services rendered by allowing the craftsman or his subcontractors to register a mortgage on the property where the work was performed. In this regard, it should be noted that the statutory mortgage must not only be requested, but also registered within a four-month (forfeiture) period from the completion of the work (art. 839 para. 2 SCC). In this case, the date of completion of the work was not specified in the judgment, but the final invoices were dated November 30, 2013. It was not until February 2014 that the Contractor became aware of issues concerning the outstanding balance of his invoices. Assuming that the work had been completed shortly before the final invoices were issued, it is reasonable to conclude, as the Federal Supreme Court notes in its *obiter dictum*, that the Contractor could have applied for registration of this mortgage within the four-month deadline through a request for provisional or even super-provisional measures. This would likely have prompted the court to immediately order to register the provisional legal mortgage with the Land Registry. Such action could have spared the Contractor a lengthy and costly process to enforce his rights. This omission is aggravated by the absence of a written work contract, which would have made it easier to identify the contracting party – and thus the debtor of the unpaid invoices.

Other sources presenting the case

Université de Neuchâtel, immodroit.ch, Jurisprudence ad TF 4A_342/2023 du 5 juin 2024, « *Société simple; solidarité et consorité; société simple et consorité; interprétation des manifestations de volonté; rapports internes et externes en société simple et en société tacite; art. 18, 19, 143 ss, 530 ss CO; 70 ss CPC* ».

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