# Unsuccessful claims of a former distributor: no indemnity for goodwill and no set-off of counterclaims

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Valid contractual waiver of set-off and no goodwill indemnity because the distribution contract was not exclusive.

Judgment of the Federal Supreme Court of 4 March 2022

Case reference : 4A_393/2021

## Facts

In 2001, two companies entered into a distribution agreement (the "Distribution Agreement") whereby one of them (the "Distributor") undertook to distribute the products of the other (the "Manufacturer") in a specified territory (the "Territory"). It should be noted that the Distribution Agreement made a distinction between "Standard Customer Sales" and "Direct Deliveries".

From the year 2013, the parties' relationship experienced some ups and downs. At that same time, the Manufacturer started to distribute its products in the Territory through another company (the "Second Distributor"). The Manufacturer thus worked with two distributors at the same time on the Territory.

On November 16, 2014, the Distributor requested that the Manufacturer terminate its contract with the Second Distributor, which the Manufacturer refused to do.

Over the course of the next year, the Manufacturer notified the Distributor of its intention to terminate their business relationship. In this context, the Manufacturer required from the Distributor the payment of numerous open invoices, but the Distributor declined to pay and instead declared to set-off these invoices with several of its own claims (goodwill indemnity, compensation for accrued commissions, for reimbursement for goods to be returned, and for damages).

Upon the Distributor's refusal to settle the open invoices, the Manufacturer brought action against the Distributor before the Court of First Instance. In turn, the Distributor requested, by way of counterclaim, that the Manufacturer be ordered to pay a goodwill indemnity. At a later stage of the proceedings, the Distributor modified its prayers for relief and asked for the payment of an additional compensation. The Court of First Instance upheld the Manufacturer's claim and ordered the Distributor to pay the open invoices. It rejected the Distributor's goodwill indemnity counterclaim.

The Distributor challenged this ruling before the Court of Appeal, but without success. The Distributor therefore brought the case before the Federal Supreme Court.

## Issue

The Federal Supreme Court was called upon to rule on three contentious issues: *i)* whether the Distributor was entitled to modify the prayers for relief of its counterclaim; *ii)* whether the Distributor was entitled to set-off its own alleged claims against the claims of the Manufacturer; and *iii)* whether the Distributor was entitled to a goodwill indemnity.

Because of its very case-specific nature, this commentary will not address the first issue (modification of the prayers for relief) and will focus on the last two.

## Decision

As mentioned, the Federal Supreme Court first had to determine whether the Distributor was entitled to set-off its own alleged claims against the claim of the Manufacturer. Indeed, the Distributor disputed the Court of Appeal's assessment that the parties had agreed to waive the possibility to set-off their respective claims.

The relevant clause of the Distribution Agreement, Art. 7.2, provided that "Claims by the 'Distributor' must not be set off against claims by the 'Manufacturer". According to the Distributor, the mere fact that this clause did not contain a time limit did not mean that the waiver of set-off was valid for an unlimited period of time. On the contrary, as the waiver of set-off only referred to the current business, a procedural set-off (i.e., a set-off occurring once court proceedings already started) should always be possible.

The Federal Supreme Court observed that the Distributor was right in considering that the context of the entire Art. 7.2 of the Distribution Agreement should be taken into account in order to interpret the meaning of the waiver of set-off. However, the Federal Supreme Court observed that the purpose of Art. 7.2 was precisely to benefit the Manufacturer in the event of a termination of the contractual relationship by providing it with a means of pressure on the Distributor if the latter refused to fulfill its obligations. It would therefore be contrary to the purpose of this clause if the waiver of set-off were to be construed as terminating at the same time as the termination of the contract.

The Federal Supreme Court confirmed that the Court of Appeal had reached the correct conclusion that the Distributor was not entitled to assert its alleged claims by way of set-off. If the Distributor had wanted to assert its alleged claims against the Manufacturer, it should have initiated separate proceedings instead.

The Federal Supreme Court then had to determine whether the Distributor could claim a goodwill indemnity following the termination of the Distribution Agreement.

The relevant provision is Art. 418u of the Swiss Code of Obligations ("SCO"). According to this provision, an agent may claim compensation for clientele if *i)* his activities have led to a significant increase in the principal's clientele and *ii)* the principal derives a benefit from this increase even after the end of the agency relationship.

Art. 418u SCO applies to commercial agency contracts, and not to distribution contracts. However, the Federal Supreme Court has recently recognized (case reference ATF 134 III 497) that Art. 418u SCO can also apply by analogy to exclusive distribution contracts, when the position of the distributor is comparable to that of an agent, in the sense that the distributor can be considered as being integrated in the manufacturer's distribution system.

The Court of Appeal found that the "Direct Deliveries" had the characteristics of a typical agency contract pursuant to Art. 418a et seq. SCO. Art. 418u SCO would have been directly applicable to the portion of the goodwill indemnity claim arising from this part of the Distribution Agreement. However, as the Distributor had not demonstrated which part of its total turnover corresponded to  Direct Deliveries", it was not possible to determine a corresponding goodwill indemnity. This aspect of the case was not addressed in more detail by the Federal Supreme Court due to the lack of sufficiently detailed grievances in the Distributor's appeal.

On the other hand, the Court of Appeal found that "Standard Customer Sales" showed the features of a typical exclusive distribution agreement. However, in the case at hand, the Court of Appeal found that the Distributor's position was not comparable to that of an agent. In particular, the Court of Appeal had noted that the Distributor and the Manufacturer closely cooperated in the distribution of the products (launching advertising campaigns, carrying out PR programs, maintaining a certain stock of goods, training of sales personnel by the Manufacturer, etc.). However, it had also noted that the Distributor enjoyed a great deal of freedom in important areas (no non-compete obligation, no obligation to send to the Manufacturer the names and addresses of customers, etc.). Thus, the Distributor was not sufficiently integrated into the Manufacturer's distribution system to be equated with an agent. The Court of Appeal therefore reached the conclusion that it was not justified to apply Art. 418u SCO by analogy to the Distributor. The Distributor challenged this finding before the Federal Supreme Court.

The Federal Supreme Court came to the same conclusion that Art. 418u SCO could not be applied by analogy to the Distributor, but adopted a different reasoning from the one of the Court of Appeal. Indeed, the Federal Supreme Court found that, according to the Distribution Agreement, the Distributor's status was "non-exclusive". On the contrary, although the Distributor was *de facto* the only one active in the Territory, the Manufacturer had expressly reserved – subject to certain conditions – the right to appoint other distributors[1]. The Federal Supreme Court thus stated that what was relevant was not a factual exclusivity, but the existence of a legal exclusivity which would derive from the existence of a contractual obligation of exclusivity that would have been granted by the Manufacturer to the Distributor. The Federal Supreme Court found that the parties had not agreed on such an obligation of exclusivity in this case. For this reason already, it was not justified to apply Art. 418u SCO by analogy to the Distributor. The Distributor was therefore not entitled to a goodwill indemnity.

## Key takeaways

This case is of particular interest insofar as it allowed the Federal Supreme Court to revisit and clarify its previous case law (case reference ATF 134 III 497) concerning the application by analogy of Art. 418u SCO to exclusive distribution contracts: a goodwill indemnity can be due only to an exclusive distributor, whose exclusivity must result from a corresponding contractual obligation of the manufacturer. In addition, this case sheds light on the (somewhat unfortunate) effects of waiver of set-off clauses.

## Comments

As noted above, this decision offers an interesting development of the case law on goodwill indemnity and exclusive distribution agreements. The topic has attracted quite a bit of interest in the Swiss legal community, so it is worth recalling briefly the evolution of the case law in this regard.

Prior to 2008, Swiss courts considered that a sole distributor was not entitled to claim a goodwill indemnity as they held that the compensatory mechanism of Art. 418u SCO – tailored to the commercial agency contract – should not be applied by analogy to an exclusive distribution contract. Indeed, it was deemed "new and exceptional in the civil law system that a party who has performed all his obligations must compensate his co-contractor for the benefits he derives from the performance of the contract after it has ended", and that therefore "this controversial innovation [i.e., the clientele compensation] cannot be extended" (cf. notably ATF 88 II 169 and SJ 1970 33). However, the Federal Supreme Court expressly reserved particular cases where "the supplier, for example, reserves a very broad right of control and obliges the representative to integrate himself into his sales organization, to provide him with information or to transfer his customer base to him at the end of the contract" (cf. ATF 88 II 169).

Such a particular case had not been recognized until ATF 134 III 497. In this decision, the right to a goodwill indemnity was granted to the exclusive distributor because, among other factors, the distributor was contractually obliged to make minimum purchases, was obliged to invest in advertising campaigns, was obliged to maintain a certain stock of goods, and was obliged to communicate to the supplier a list with the names and addresses of the customers. In view of all these obligations, the Federal Supreme Court found that it was justified to grant the distributor the same protection as an agent.

This decision was later confirmed by the Federal Supreme Court case law. However, subsequent court decisions have highlighted the remaining uncertainties relating to the granting of a goodwill indemnity to exclusive distributors. For instance, in a 2018 decision, the Federal Supreme Court rejected the allocation of a goodwill indemnity to an exclusive distributor on the grounds that the distributor had not alleged the relevant facts allowing the calculation of the indemnity (case reference 4A_27/2018). Similarly, in a 2019 decision, the Federal Supreme Court rejected the allocation of such an indemnity on the grounds that the exclusive distributor had not demonstrated that it had built up a clientele for the supplier (case reference 4A_71/2019). In both cases, the Federal Supreme Court did not analyze whether the specific conditions for an application by analogy of Art. 418u SCO to a an exclusive distribution contract were met.

Here too, the Federal Supreme Court avoided to analyze whether all the conditions for an application by analogy of Art. 418u SCO were met. The unwillingness to deal with this specific question perhaps betrays a certain discomfort on the part of the Federal Supreme Court with the criteria which it itself set out in its case law ATF 134 III 497 to determine whether or not the situation of the distributor was comparable to that of an agent (namely, the obligation for the distributor to carry out an annual minimum of purchases, to maintain a certain stock of goods, to grant a right of inspection in its books to the supplier, to communicate to the supplier a list of customers, etc.). It should further be noted that the analysis of the Court of Appeal on these aspects (quoted extensively in recital 6.1.2) does not lead to a clear-cut conclusion: on the contrary, in view of the circumstances of the case, it seems to us that the Court of Appeal could just as well have concluded that the Distributor's situation was comparable to that of an agent. This demonstrates the difficulties linked to the implementation of such indefinite criteria.

Regardless of these considerations, it seems that this decision could have offered the opportunity to look into the question, little discussed to our knowledge, of the application by analogy of Art. 418u SCO to non-exclusive distribution contracts. Indeed, if an analogy between a sole distributor and an agent is justified because of the potential link of control and dependence that may be created between a distributor and a supplier (cf. also Dreyer Dominique, Contrats de distribution : deux questions, *in* Pichonnaz Pascal/Werro Franz, La pratique contractuelle 3, Genève 2012, p. 135 et seq.), it is difficult to see why the non-exclusive distributor should be excluded *a priori* from the protection of Art. 418u SCO, since a non-exclusive distributor could very well be integrated into a distribution network and find himself under the influence of the manufacturer.

One can further note that in this case the possibility for the Manufacturer to appoint additional distributors in the Territory was subject to certain conditions. It is therefore not so much the legal qualification of an exclusive or non-exclusive distribution contract that should be decisive for the assessment of the right to a goodwill indemnity, but rather the actual position of the distributor vis-à-vis the supplier.

This case could have offered the opportunity to analyze more precisely the meaning of the contractual provision relating to the issue of the exclusivity. The very detailed provision (Ar. 2.2 of the Distribution Agreement quoted in footnote) indicates that the Manufacturer did not have full freedom to appoint other distributors unless certain objective conditions would be met. The relevant clause provides indeed that: "At the time of entering into this contract, the 'Manufacturer' has no intention to nominate further distributors or agents for the sale of 'Products' in the 'Territory'. However, he may do so in the event that the 'Distributor' is not in a position or willing to represent the 'Manufacturer's' interests regarding all the 'Products' in the 'Territory'. The Manufacturer will especially consider such a step if he encounters a risk to lose business or his market position regarding the 'Products' in the 'Territory'". This could have been used as an argument to establish that as long as these conditions were not met, the former distributor did indeed have a contractual exclusivity in the relevant territory. From this perspective, one could consider that the distributor did benefit from a certain exclusivity, even if is was limited.

Let us add a comment concerning contractual clauses prohibiting the parties from offsetting their reciprocal claims.

The possibility for two parties to set-off mutual claims is expressly provided for in Art. 120 para. 1 SCO. This possibility is recognized even if the offsetting claim is disputed (Art. 120 para. 2 SCO). However, freedom of contract allows the parties to waive their right to set-off (Art. 126 SCO).

In the case at hand, the parties had agreed to a waiver of set-off in favor of the Manufacturer, i.e., the Distributor could not set-off its claims against the Manufacturer's claims. However, as shown in this decision, the wording chosen by the parties, although seemingly straightforward, may raise questions of interpretation, particularly in relation to the time limit of the waiver. Here, both the Court of Appeal and the Federal Supreme Court came to the conclusion that the waiver of set-off should continue to have effect not only after the end of the contractual relationship (which can be justified on logical grounds), but also after the commencement of legal proceedings, which – as the Federal Supreme Court itself conceded – does not seem to be adequate to achieve effective proceedings. Indeed, by preventing the Distributor from offsetting its claims, it is forced to take them to court and to initiate a second procedure.

To avoid any uncertainty in this regard, it seems advisable for the parties negotiating a waiver of set-off to address the question of its time limit and to expressly implement their decision into their agreement.

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[1] Art. 2.2. of the Distribution Agreement provides that: "The status of the 'Distributor' is 'non-exclusive'. At present he acts as the only distributor in the 'Territory' for the 'Manufacturer' for all 'Products'. At the time of entering into this contract, the 'Manufacturer' has no intention to nominate further distributors or agents for the sale of 'Products' in the 'Territory'. However, he may do so in the event that the 'Distributor' is not in a position or willing to represent the 'Manufacturer's' interests regarding all the 'Products' in the 'Territory'. The Manufacturer will especially consider such a step if he encounters a risk to lose business or his market position regarding the 'Products' in the 'Territory' (…)".

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