Breach of an exclusivity obligation in a M&A advisory contract: no liability?

MALAK AHMADOV-EL ADDAL

Consequences of a client breaching the exclusivity obligation in a Merger and Acquisition advisory contract that provides for a success fee for the broker.

Judgment of the Federal Supreme Court of 16 April 2020
Case Reference : 4A_449/2019

Facts

A client (the Client) and a bank offering corporate finance services (the Bank) entered into an agreement (the Agreement), according to which the Bank had to assist the Client sell two companies (the Companies) owned by the latter (M&A advisory services). The Agreement provided that the Bank was entitled to a success fee amounting to 4% of the selling price if the transaction was completed (original text [in French]: "[…] *si la transaction est menée à bien*") (Art. 4 para. 4 of the Agreement). The parties had also agreed on an exclusivity clause (Art. 6 of the Agreement) whereby the Client shall be obliged to inform the Bank of any and all contact already initiated or established with prospective buyers and to redirect them to the Bank.

The Agreement had also provided that, in the event the Agreement was terminated by the Client without fault of the Bank, the latter would receive the success fee if the indication given or the negotiation and the work carried out by it contributed to the conclusion of a purchase agreement within 24 months following the termination of the Agreement (Art. 7 para. 3 of the Agreement).

Following the conclusion of the contract, the Bank had provided the Client with a list of companies that could be interested in acquiring the Companies, as well as with a publication consisting in a ranking of French companies providing digital services (the Top List). Subsequently, the Bank had contacted a couple of potential buyers and later arranged a meeting between one of them and the Client. On the date the meeting was set to take place, the Client terminated the Agreement with immediate effect, stating personal and economic reasons. Later, it was discovered that two days before the meeting was set to take place, the Client had sold the Companies at a purchase price of around EUR 9 million to Group D (the Buyer), a company that was listed on the Top List. This sale had been conducted through another broker (other than the Bank) with whom the Client had also concluded a brokerage contract providing for a 4% success fee. The Client admitted that it had not informed the Bank that the Buyer was interested in purchasing his companies and that he had deliberately not informed the Bank about the negotiations led by the other broker with it.

The Bank claimed payment of the success fee, which the Client refused to pay. In the context of the Bank's legal action against the Client, the Bank argued that according to the exclusivity clause (Art. 6) and Art. 7 of the Agreement, it was entitled to the success fee irrespective of a causal link between its actions and the transaction in question. The Client, on the other hand, argued that the parties did not waive the requirement of such a causal link.

The Cantonal Court of Appeal found that the Client had violated the exclusivity clause and, as a result thereof, ordered the Client to pay the Bank compensatory damages amounting to the payment of the agreed fee (i.e. approximately EUR 361,000). The Client appealed to the Federal Supreme Court.

Issue

The Federal Supreme Court had to determine the consequences of the breach of the exclusivity clause committed by the Client by interpreting the relevant provisions of the Agreement (namely Arts. 6 and 7 para. 3).

Decision

According to Art. 413 para. 1 of the Swiss Code of Obligations ("SCO"), the broker's fee becomes payable as soon as the information he has given or the intermediary actions he has carried out result in the conclusion of the contract. It follows from this provision that there must be a *causal* link between some action on part of the broker and the conclusion of the intended transaction for the broker's fee to be payable.

Art. 413 para. 1 SCO however is not a mandatory rule (i.e. parties can waive it by contract). Parties can decide to mitigate the random nature of the broker's remuneration in a number of ways, namely:

- by waiving, completely, the causal link requirement between the broker's activity and the conclusion of the transaction, the broker being entitled to his fee even though his actions did not contribute to the conclusion of the transaction by the client; or
- by agreeing upon an exclusivity clause whereby the client undertakes not to conclude brokerage contracts with third party brokers in relation to the intended transaction.

Regarding the consequences of a breach of the exclusivity clause, the Cantonal Court of Appeal interpreted the relevant contractual clauses (Art. 18 SCO) and found that the true intention of the parties (i.e. the subjective intention of the parties) could not be ascertained. Such finding had not been challenged and therefore could not be reviewed by the Federal Supreme Court. The latter could, however, review the interpretation of the contract by using the objective method of interpretation and could hence determine, in accordance with the good faith principle, which consequences the parties intended to attach to a breach of the exclusivity clause (i.e. the objective intention of the parties).

Based on the foregoing principles, the Federal Supreme Court held that Art. 7 para. 3 of the Agreement did not only apply in the event of termination of the contract, but *also* in case of a breach of the exclusivity clause. The Federal Supreme Court considered that the parties' objective intention was that the success fee had to be paid only if the actions of the Bank directly or indirectly led to the intended transaction (as required by Art. 7 para. 3 of the Agreement), even in the event of a breach of the exclusivity clause.

It thus remained to be assessed whether the causal link requirement described in Art. 7 para. 3 of the Agreement was fulfilled. The contact between the Client and the Buyer had been facilitated by another broker than the Bank. The fact that the name of the Buyer was mentioned in the Top List made no difference since the Bank had neither direct contact nor any special relationship with the Buyer. Accordingly, the causal link requirement had not been fulfilled and the Federal Supreme Court dismissed the Bank's claim.

Key takeaway

The judgment underscores the importance of defining precisely the consequences of a breach of an exclusivity clause in a brokerage contract, which is critical if the parties agreed on a success fee. Explicit language (which was missing in this case) indicating that such breach would trigger the client's liability (irrespective of a causal link required [or not] for a success fee to be payable) should be included in the agreement in order to protect the interests of the exclusive broker.

Comments

The gross violation of the Agreement committed by the Client, which consisted in hiring a second broker as well as withholding information that the Buyer was interested in purchasing his companies, had no consequences.

Although the parties' intention is decisive in the context of interpreting the contract, the result reached by the Federal Supreme Court is not fully convincing.

Relying on Art. 7 of the Agreement to determine the consequences of the violation of the exclusivity clause neither corresponds to the parties' objective intention, nor is it plausible in light of the contract as a whole and the purpose pursued by the parties. Indeed, how can there possibly be a causal link between the conclusion of the purchase agreement with the Buyer and the Bank's actions given that the Client did not refer this prospective buyer to the Bank (knowing that he had the contract obligation to do so pursuant to Art. 6 of the Agreement)? In other words, the causal link requirement under Art. 7 of the Agreement cannot be fulfilled in a situation (such as the one that occurred in this case) where there is a breach of the exclusivity clause. Accordingly, the payment of the success fee cannot depend on a causal link between the Bank's actions and the intended transaction in the event of a breach of the exclusivity clause.

The court holding that it is necessary to show a causal link between the actions of the Bank and the conclusion of the

contract ultimately makes it possible for the Client to prevent – by his conduct – the fulfillment of the condition (i.e. a causal link) entitling the Bank to receive its success fee. One could have (which was not done by the Federal Supreme Court) relied on Art. 156 SCO, a provision which constitutes a concretization of the general prohibition against an abuse of right (Art. 2 para. 2 of the Swiss Civil Code [SCC]) and which provides that "[a] condition is deemed fulfilled where one of the parties has prevented its fulfilment by acting in bad faith". Applied to the case in question, this provision would have resulted in the Bank receiving the success fee, since the Client had, arguably at least, prevented the fulfilment of the condition for the payment of the success fee "by acting in bad faith" within the meaning of Art. 156 SCO (see the comment on this case by Markus Vischer, cited in Other sources commenting the case below).

When addressing the issue of a violation of an exclusivity clause, the Federal Supreme Court in an earlier ruling[1] provided two solutions. A breach of this clause can either lead to:

- the broker's right to compensatory damages amounting to the payment of the agreed fee according to the general principles of contract law (Arts. 97 para. 1 and 98 para. 2 SCO); *or*
- the payment of the agreed commission.

The choice between either solution depends primarily on the intention of the parties.

In view of the foregoing, one might wonder why the Bank argued that a causal link was not required for the payment of a success fee rather than relying on the Federal Supreme Court's earlier ruling and claiming a right to be paid the success fee either in the form of compensatory damages (by applying the relevant Swiss contract law principles), or directly (based on the objective intention of the parties – which, unfortunately, was wrongly construed in this case).

Other sources presenting the case

Strotz Vera/Galli Dario/Vischer Markus, Von wirkungslosen Vertragsklauseln, in: dRSK 21, published on September 21, 2020; Vischer Markus, BGer 4A_449/2019: Entschädigung im Falle der Verletzung der Exklusivitätsklausel, in: AJP 9/2020, 1200 ff., available at: https://www.walderwyss.com/user_assets/publications/VISCHER_MARKUS_AJP-9_2020_1200.pdf

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[1] See ATF 100 II 361, consid. 4.

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