Is a Supplier liable for the non-delivery of medical products under an international Wholesaler Sales Agreement?

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In a dispute over a pharmaceutical distribution contract in Central Africa, the Federal Supreme Court held that a temporary interruption of deliveries falls under the rules of debtor default, while a definitive cessation of deliveries constitutes a breach not covered by a standard liability exclusion clause. Moreover, a party that permanently withdraws from performance cannot rely on the defense of non-performance under Article 82 of the Swiss Code of Obligations (SCO).

Judgment of the Federal Supreme Court of 18 April 2024
Case Reference : 4A_237/2023

Facts

A. (the "Buyer") and B. (the "Supplier") were parties to a "Wholesaler Sales Agreement" (the "Contract") governing the recurring sale and distribution of medicine in the Democratic Republic of Congo, Rwanda and Burundi. The Seller succeeded to C. (the "Predecessor") in said contract on June 1, 2014.

Para. 5.1 of the Contract contained the following clause regarding exclusion of liability ("the Exclusion of Liability Clause"):

"Delivery by C._____ of shipments of Products to WHOLESALER pursuant to this Agreement, will be done within a reasonable period of time and be dependent on availability of the Products. WHOLESALER will not be entitled to make any claim against C._____ for non-delivery or delay in delivery of the Products ordered under the Agreement; however, the WHOLESALER will be entitled to cancel the order if the Products are not delivered within four (4) months after the date of placing the order."

Due to internal audit problems, the Seller failed to deliver any medication between Q4 of 2017 and Q1 of 2018.

On March 26, 2019, it informed the Buyer that it would stop registering the medicines in the targeted countries. Five months later, the Seller formally notified the relevant health ministries of its decision. The Seller justified its actions by citing over EUR 1,000,000 in unpaid invoices by the Buyer. In early July 2019, the Seller ceased all medicine deliveries.

In June 2020, the Seller terminated the Contract with effect from July 31, 2020.

On March 11, 2021, the Seller filed a claim before the Commercial Court of the Canton of Zurich (the "Cantonal Court") seeking EUR 986,070.64 plus interest on EUR 906,966.64, for unpaid invoices.

By a decision dated March 22, 2023, the Cantonal Court partially upheld the claim and ordered the Buyer to pay the Seller EUR 984,881.02 plus interest on EUR 905,964.22. The Buyer appealed the decision to the Federal Supreme Court. It did not contest the invoices but invoked the fact that their debt was offset by two tort claims arising from the Seller's interruption of deliveries.

Issue

The Federal Supreme Court had to assess whether the Buyer's two counterclaims could be set off against the Supplier's claim for unpaid invoices:

1. A claim of EUR 219,712 for lost margin due to the interruption of deliveries during Q4 of 2017 and Q1 of 2018.
2. A claim of EUR 900,562.49 for damages related to a change in business strategy and the Supplier's failure to maintain medicine registration following the cessation of deliveries in July 2019.

The validity of both claims had to be examined with regard to the Exclusion of Liability Clause.

Decision

The Federal Supreme Court started by analyzing the validity of the first claim. The Buyer based this claim on contract liability under art. 97 para. 1 of the Swiss Code of Obligations (SCO), which imposes liability for non-performance unless the obligor proves absence of fault. The Buyer further argued that the Supplier's conduct involved gross negligence or intent, making any exclusion of liability void under art. 100 para. 1 SCO.

However, the Federal Supreme Court found that the situation constituted default, not non-performance. The damage that the Buyer allegedly suffered was caused by late deliveries, and under Swiss law, under such circumstances, specific rules regarding default apply (art. 102 and art. 103 SCO). Since the Buyer was unable to prove that it had put the Seller in default (e.g., by sending a formal reminder), no claim could arise. Consequently, the Federal Supreme Court rejected the first claim without needing to address the validity of the Exclusion of Liability Clause.

With regards to the second claim, the Federal Supreme Court had to analyze whether art. 82 SCO was applicable in such a situation. According to this provision, a party to a bilateral contract may not demand performance of the other party's obligation unless they have performed or offered to perform their own obligation first. The Seller argued that, under article 82 SCO, it had no obligation to perform as the Buyer had not fulfilled its own obligation I.e., paying outstanding invoices). The Buyer owed invoices for over EUR 1,000,000 when the definitive interruption of deliveries happened. However, according to the Federal Supreme Court, a few conditions were missing to allow this defense to come into play.

Art. 82 SCO is a dilatory defense that allows one party to a synallagmatic contract to not perform its obligation so long as the other party did not at least offer to perform its own. For it to be applicable, both obligations must be part of a single contract and must be related in such a way that one is the direct counterpart for the other. According to the Federal Supreme Court, such a direct relation exists for all payments and all deliveries in an exclusive distribution agreement. The problem lied in the fact that, according to the nature of art. 82 SCO, this defense can only be raised by a party that does not want to terminate the contract and refuse to perform its own obligations fully. In the case at hand, the Seller had informed the Buyer one month after the end of the sales that it wanted to stop registering medicine in the targeted countries. The Federal Supreme Court considered that the Seller clearly demonstrated a definitive intention to terminate the Contract and could no longer rely on article 82 SCO.

Art. 82 SCO being inapplicable, the last remaining question was whether the Exclusion of Liability Clause was a bar to the second claim. The Federal Supreme Court, interpreting the text according to the principle of good faith, considered that the clause was only targeting the temporary interruption of some specific deliveries and not a definitive interruption of all deliveries. Therefore, the non-registering of the medicines was a failure to comply with the core objective of the Contract, equivalent to a termination of it. Such a situation was not protected by the Exclusion of Liability Clause.

On that basis, the Federal Supreme Court partially upheld the claim and referred the case back to the lower court to further examine damages under the second claim.

Key takeaways

1. The performance of an obligation that is merely made more difficult, but not permanently impossible, constitutes a case of default by the debtor (art. 102 seq. SCO).
2. Scope and limits of an exclusion of liability clause (art. 100 SCO): in this case, the Exclusion of Liability Clause did not cover the definitive cessation of deliveries by the Seller.
3. A debtor who persistently refuses to perform their contractual obligations may not invoke the defense of non-performance (art. 82 SCO).

Comment

This ruling by the Swiss Federal Supreme Court concerns an exclusive distribution agreement for the sale of pharmaceuticals in several African countries. At the heart of the dispute were two damage claims, both asserted by the Buyer: the first for a temporary interruption in deliveries, and the second for a definitive cessation.

This commentary focuses on two fundamental issues:

1. The scope and limits of an exclusion of liability clause (art. 100 SCO).
2. The conditions for invoking the defense of non-performance under art. 82 SCO.

1. Scope and limits of an exclusion of liability clause (art. 100 SCO) in an exclusive distribution agreement

1. *First damage claim*

In the case of the first damage claim (temporary interruption of deliveries, EUR 219,712), the Buyer's claim, wrongly based on art. 97 SCO instead of the specific regime on default (art. 102 seq. SCO), was dismissed. The outcome reached by the Federal Supreme Court in this judgment is convincing. The performance of an obligation that is merely made more difficult, but not permanently impossible, constitutes a case of debtor default (art. 102 seq. SCO), rather than a case of non-performance or improper performance (art. 97 seq. SCO). It was incumbent upon the Buyer, who alleged non-performance of a delivery due to the Seller's internal audit, to issue a formal notice and place the Seller in default in order to obtain compensation for the resulting damage (art. 103 para. 1 SCO). Since the Buyer failed to do so, the material basis for the damage claim was not established. Consequently, the validity of the Exclusion Liability Clause (para 5.1) under art. 100 SCO was not examined.

2. *Second damage claim*

For the second damage claim (definitive cessation of deliveries, EUR 900,562.49), the Exclusion of Liability Clause was not applicable. Interpreted in accordance with the principle of good faith, the clause covered only isolated delivery delays and could not override the Seller's obligation to perform the distribution agreement in its entirety. By deciding to stop registering its products in the relevant countries, the Seller rendered the very purpose of the Contract namely the sale and distribution of pharmaceuticals in the designated territories, impossible. As a result, The Exclusion of Liability Clause could not be invoked to justify the Supplier's unilateral termination of the contract. Moreover, the parties had included a specific termination clause in the Contract (clause 9).

2. Defense of non-performance (art. 82 SCO) in the event of the debtor's definitive refusal to perform

The defense of non-performance may only be invoked if the debtor still intends to fulfill their contractual obligations. In this case, the Seller's voluntary suspension of product registration in the relevant countries rendered performance of the contract materially impossible. Once the Seller definitively withdrew from the Contract, it could no longer rely on art. 82 SCO, as which allows a party to temporarily withhold performance until the counter-performance is rendered. It is not applicable to parties who have permanently ceased performance.

This was therefore a definitive withdrawal from the Contract, which excludes the application of art. 82 SCO, whose effect is purely dilatory.

Ultimately, the Federal Supreme Court confirmed that a party who unilaterally and definitely withdraws from an exclusive distribution contract remains liable under art. 97 SCO, unless protected by a valid and applicable exclusion clause, which wasn't the case here. The case was remanded to the Cantonal Court for further examination of the remaining elements: damage, causation, and fault.

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