Liquidated Damages Awarded for Breach of an Exclusivity Obligation under an Exclusive Supply Agreement

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Following the acquisition of manufacturing capacity within its group, a client ceased purchasing hearing-aid batteries from its exclusive supplier and instead sourced the products from group companies. This conduct was held to constitute a breach of contract, and the supplier was awarded liquidated damages that were contractually agreed.

Judgment of the Federal Supreme Court of 28 April 2025
Case Reference : 4A_526/2024

Facts

Aa., Inc. (the "**Client**") is a US company incorporated under the laws of the State of Delaware, USA. It is part of the A. group (the "**Client Group**"). B. GmbH (the "**Supplier**") is a German company.

Until 2015, both companies manufactured and distributed hearing-aid batteries. In 2014, the Client decided to focus exclusively on distributing hearing-aid batteries. The Client sold its means of battery manufacturing and packaging to the Supplier.

On October 5, 2015, the Client and the Supplier entered into a master supply agreement regarding the sale and delivery of hearing-aid batteries (the "**MSA**"). On October 19, 2015, the parties revised the MSA by entering into an amended and restated master supply agreement (the "**ARMSA**").

On January 16, 2018, the parent company of the Client Group announced that it was to acquire the battery business of the US conglomerate C. Holdings, Inc. (the "**Battery Business**"), including its hearing-aid battery business (the "**Acquisition**").

On December 21, 2018, in preparation for the Acquisition, the Client and the Supplier entered into an amendment to the ARMSA (the "**Amendment**"), which modified some provisions of the MSA and subjected it to Swiss law (to the exclusion of the United Nations Convention on Contracts for the International Sale of Goods (CISG) and other international treaties). The Amendment included, inter alia, the following provisions (in original English):

"[Section 1.h] Designation as Exclusive Supplier: In exchange for Sections 1.f and 1.g, [Client] designates [Supplier] as [Client]'s (and, for clarification, as all [Client]'s subsidiaries and affiliates, excluding the entities acquired in connection with the Acquisition) exclusive Supplier of Products."

"[Section 1.j] In the event that [Supplier] alleges that [Client] breaches Section 1.h., [Supplier] shall so notify [Client] in writing without undue delay setting out details of the alleged breach, and, if requested, provide to [Client] reasonable documentation to support its allegation, and [Client] shall, without undue delay, evaluate the allegation; [Client] shall, without undue delay, review and respond to [Supplier]'s allegation. After such evaluation, [Client] will discuss in good faith with [Supplier] the appropriate remedial action to be taken, in particular the purchase of the Products in question. If the parties, even after involvement of the top-level management, do not reach an agreement on the appropriate remedial action within a reasonable period, and if [Client] breaches Section 1.h., [Client] shall pay to [Supplier] the Liquidated Damages. The parties intend that the Liquidated Damages constitute compensation, and not a penalty. The parties acknowledge and agree that [Supplier]'s harm caused by such a breach by [Client] would be impossible or very difficult to accurately estimate as of the Effective Date, and that the Liquidated Damages are a reasonable estimate of the anticipated or actual harm that might arise from such a breach. [Client]'s payment of the Liquidated Damages is [Client]'s sole liability and entire obligation and [Supplier]'s exclusive remedy for such breach. However, in the event [Client] breaches Section 1.h and [Client] shall pay to [Supplier] the Liquidated Damages as set forth above, the following applies: [Client] may take

up to a maximum of thirty (30) days to review and respond to [Supplier]'s allegation."

"[Section 1.i] ['Liquidated Damages' means] an amount equal to two (2) times the amount paid by [Client] to [Supplier] in the prior twelve (12) month period provided, that if the Agreement term has not extended for 12 months, the amount shall be equal to the average amount paid by [Client] over the most recent three (3) months period multiplied by 24 […]."

In addition, pursuant to Section 5.c ARMSA, the means of hearing-aid battery manufacturing and packaging sold by the Client to the Supplier, were to be used by the Supplier exclusively for the benefit of the Client. The Client also enjoyed the right to be offered Supplier's products with a technological edge on the same terms as other clients.

The Acquisition was completed on January 2, 2019. The contractual relationship between the Parties continued normally until June 2020, when the Client began purchasing hearing-aid batteries from the newly acquired Battery Business. The Client gradually reduced the volume of its purchases from the Supplier and, in November 2020, ceased all purchases.

On November 24, 2021, the Supplier filed a claim before the Handelsgericht des Kantons Zürich (the "**Cantonal Court**"). The Supplier claimed that by ceasing to purchase its hearing-aid batteries, the Client has breached the exclusive supply relationship between the parties, set out in Section 1.h of the Amendment, and consequently sought payment of liquidated damages (USD 14,885,536.86 plus interest) in accordance with Section 1.j of the Amendment.

On August 27, 2024, the Cantonal Court partially upheld the claim and ordered the Client to pay the Supplier USD 10,963,160.12 with interest. The Client appealed to the Federal Supreme Court.

Issue

The Federal Supreme Court addressed whether the Cantonal Court correctly held that (i) the Client breached the exclusivity obligation by ceasing to purchase hearing-aid batteries from the Supplier and instead sourcing them from related companies during the initial term, and (ii) the Supplier had incurred damages giving rise to the payment of contractually agreed liquidated damages.

Decision

1. *Breach of contract by the Client*

According to the Cantonal Court, under the amended ARMSA (the "**Contract**"), the Client was not permitted to permanently reduce its orders to zero and purchase hearing-aid batteries from related companies. This constituted a breach of contract.

The Cantonal Court based its reasoning on an objective interpretation of the Contract in accordance with the principle of trust (*Vertrauensprinzip*, *principe de la confiance*), pursuant to which declarations of intent must be interpreted as they could and should have been understood in good faith based on their wording and context, as well as the overall circumstances. This interpretation can be substantially summarized as follows:

- The Cantonal Court first noted that the parties agreed on the Supplier being the "Exclusive Supplier" of the Client, but that it could not clearly infer from this designation that the Client was prohibited from purchasing hearing-aid batteries from related companies.
- Second, the Cantonal Court examined the purpose of the Contract. The Cantonal Court noted that the Contract was designed as a reciprocal cooperation: the Client fully transferred its manufacturing and packaging capacity to the Supplier, but was guaranteed the supply of hearing-aid batteries from the Supplier, which committed to using the transferred capacity exclusively for the Client. The Client was further granted the right to be offered the Supplier's products with a technological edge on the same terms as other clients. In addition, the Supplier could not sell 'as is' the hearing-aid batteries manufactured for the Client to third parties. Compliance with said obligations was further guaranteed by liquidated damages that had to be paid by the Client in case of breach.
- Third, the Cantonal Court examined the interests at stake and noted that although no minimum purchase quantities has been agreed, a permanent reduction in the order quantity to zero during the contractual term would be equivalent to a premature withdrawal from the Contract by the Client. This would ultimately lead to a unilateral shift of interests in favor of the Client.
- Fourth, the Cantonal Court examined the background of the Contract, and noted that, despite the Acquisition, the Contract was extended for 5 years up to September 30, 2025, indicating an expectation that the Client wanted to continue to be supplied with hearing-aid batteries at least until the term of the Contract. The

Supplier's rights were also newly secured by liquidated damages in case of breach.
- Finally, the Cantonal Court considered accompanying circumstances, and noted that the forecast dated June 2020 submitted by the Client projected unchanged demand for hearing-aid batteries until January 2021, and that the Client only notified the Supplier of reductions in July 2020, indicating that the drop in demand was driven solely by internal business reasons.

The Federal Supreme Court largely upheld the reasoning of the Cantonal Court, except for the consideration of the parties' conduct after the conclusion of the Amendment, which was not relevant to objective interpretation.

In particular, the Federal Supreme Court noted that the Cantonal Court rightly assumed that even if the parties had not agreed on minimum purchase quantities (and thus also no fix quantities), this does not mean that the Client was entitled to permanently suspend its orders and thus effectively withdraw from the Contract. The Client was required to continue purchasing hearing-aid batteries from the Supplier during the term of the Contract. Further, whether the Client was entitled to manufacture hearing-aid batteries 'in-house' was irrelevant, as the Battery Business had been acquired by the parent company of the Client Group, and not the Client itself.

2. *Damages suffered by the Supplier*

The Cantonal Court held that the Supplier had suffered damages. The Federal Supreme Court examined whether this finding was justified.

The Federal Supreme Court noted that liquidated damages (*Schadenspauschalierung*, *fixation forfaitaire du dommage*) are not explicitly regulated by the Swiss Code of Obligations ("**SCO**"), but it is recognized in practice that parties to a contract may predetermine the amount of damages by agreeing on liquidated damages. Pursuant to such an agreement, if a specific liability event occurs, the predetermined amount is payable as compensation for damages incurred. Such an agreement releases the creditor from proving the quantification of the damages, but, in principle, not from proving their occurrence, unlike contractual penalties (*Konventionalstrafe*, *peine conventionnelle*) within the meaning of Art. 160 et seq. SCO.

Whether stipulation of liquidated damages also releases the creditor from proving the occurrence of damages is disputed among legal scholars. Three views can be distinguished: (i) the liquidated damages clause affects the burden of proof only with respect to the quantification of damages, while the creditor must still prove that damages occurred; (ii) the liquidated damages clause relieves the creditor from proving both the occurrence and the quantification of damages; and (iii) the liquidated damages clause relieves the creditor from proving the damages, but the creditor must still substantiate, but must not prove, the damages.

The Federal Supreme Court took the view that a liquidated damages clause per se neither releases the creditor from proving that damages have occurred, nor obliges the creditor to prove such occurrence. Rather, the parties to a contract are free to allocate the burden of proof and factual allegation within the scope of their contractual freedom. Accordingly, the parties may agree, within the framework of a liquidated damages clause, to release the creditor from proving damages provided that the debtor retains the opportunity to prove the absence of damage. Otherwise, the clause would qualify as a contractual penalty.

On this basis, the Federal Supreme Court assessed whether the liquidated damages clause in the case at hand entailed a shift in the burden of proof as to the occurrence of damages. The Federal Supreme Court noted that, although the wording of the Contract did not explicitly indicate such a shift, it can be inferred from the wording that the will of the parties was to release the Supplier not only from proving the amount of damages, but also from proving that damages had occurred, while preserving the Client's opportunity to demonstrate the absence of damage.

This intent was reflected in the contractual framework: in the event of a breach of Section 1.h of the Contract by the Client, the parties intended that the Client would be required to pay liquidated damages to the Supplier after completion of the stipulated formal escalation process. Furthermore, the liquidated damages were intended to cover both actual damages and expected losses that might arise from the breach of contract. Finally, the parties agreed that the liquidated damages are intended to constitute compensation rather than a penalty, noting that the damages caused to the Supplier by a breach of contract were impossible or difficult to quantify at the time the ARMSA was concluded.

Accordingly, the Cantonal Court correctly held that the Supplier suffered damages, as it was irrelevant whether the Supplier had sufficiently alleged or proved the damages in the case at hand. The Client was obliged to pay liquidated damages because it breached the Contract and the Supplier complied with the stipulated formal escalation process.

Furthermore, the Client failed to prove that the Supplier had suffered no damage.

In view of the above, the Federal Supreme Court upheld the judgment handed down by the Cantonal Court, and thus rejected the appeal brought forward by the Client.

Key takeaway

Notwithstanding the absence of minimum purchase obligations or fixed purchase quantities, a client bound by an exclusive supply agreement may not reduce purchases to zero and source from group companies instead of the exclusive supplier.

Contractual clauses setting out liquidated damages (*Schadenspauschalierung, fixation forfaitaire du dommage*) per se neither relieve the creditor from proving that damages have occurred, nor impose on the creditor an obligation to prove such occurrence. The scope and effect of a liquidated damages clause must be determined in accordance with the rules governing contract interpretation.

Comments

This case is of particular relevance to two issues that often give rise to disputes in the context of exclusive supply agreements, namely minimum purchase obligations and in-house manufacturing. In addition, it further sheds light on the enforcement of liquidated damages in this contractual context.

Often, it is unclear whether a client that has undertaken to source exclusively from a supplier may reduce purchase quantity and if it is permitted to manufacture the relevant products in-house or to purchase them from group companies.

1. *Minimum Purchase Obligations*

Regarding the first issue, the Federal Supreme Court held that, although the parties had not agreed on minimum purchase obligations or fixed quantities, this did not entitle the Client to indefinitely suspend its orders, which constitutes a de facto withdrawal from the Contract. The Client was required to continue purchasing hearing-aid batteries from the Supplier during the term of the Contract.

Although this outcome was upheld in the case at hand, it is doubtful that it can be applied to exclusive supply agreements (or comparable arrangements) in general. The Federal Supreme Court's reasoning rests heavily on the particular factual matrix, notably the existence of a specific reciprocal cooperation. In particular, the Supplier's manufacturing capacity was dedicated exclusively to the Client, and the parties had legitimate expectations regarding the continued placement and acceptance of purchase orders by the Client. More importantly, even after the Client Group acquired companies capable of manufacturing hearing-aid batteries, the parties elected to extend the exclusive supply agreement for an additional five years. Moreover, the Supplier's position was further strengthened by the introduction of liquidated damages provisions in the event of breach.

Undeniably, parties to an (exclusive) supply agreement share an interest in ensuring that each assumes obligation to purchase and supply, respectively. In practice, however, contracting parties often refrain from stipulating minimum or fixed quantities to preserve commercial flexibility. On the one hand, the client seeks to avoid being tied to excessive commitments that might exceed market demand, while on the other hand the supplier retains the ability to allocate production capacity to other clients. Rather than prohibiting what amounted to a permanent reduction of purchase volumes (which was found by the Federal Supreme Court in this case), parties may opt to protect their respective interests by resorting to alternative contractual mechanisms. One common approach is the use of forecasts, which, once binding within defined lead times prior to manufacturing, provide the client with assurance of supply while simultaneously allowing the supplier to secure sufficient demand and plan capacity allocation.

The solution adopted by the Federal Supreme Court raises a further question: what volume must be purchased in order to remain compliant with an exclusive supply agreement when no minimum purchase obligations are stipulated?

2. *In-House Manufacturing*

Regarding the second issue, the Federal Supreme Court did not definitively decide whether in-house manufacturing is permissible under the exclusive supply agreement in the case at hand. The Federal Supreme Court nevertheless appeared to recognize a breach of contract in the Client sourcing products from group companies. However, the breach was grounded primarily in the Client's permanent reduction of orders to zero, thereby effectively withdrawing from the

Contract (as discussed above), rather than sourcing products covered by the exclusive supply agreement from group companies.

In our view, the concept of 'in-house' manufacturing could legitimately extend to manufacturing carried out by group companies, although this should ultimately depend on the will of the parties in a case-by-case basis. Within corporate groups, operational functions are often distributed across multiple entities, frequently across different jurisdictions, with certain entities focusing on manufacturing while others assume responsibility for distribution, marketing, or other business activities. Imposing a rigid distinction between an internal department and an affiliated company (particularly when wholly-owned) would fail to reflect the economic and operational realities of how corporate groups function.

Whether a reduction in the quantities to be purchased by a client, or in-house or intragroup manufacturing, is permissible ultimately depends on the interpretation of a contract in the context of the specific circumstances of the case. To mitigate the risk of contractual ambiguity, contracting parties may consider expressly reserving the client's right to refrain from placing orders and to engage in in-house manufacturing, including, where applicable, manufacturing by group companies.

3. *Liquidated Damages*

As for the issue of liquidated damages, the Federal Supreme Court highlighted the distinction between liquidated damages (*Schadenspauschalierung*, *fixation forfaitaire du dommage*), which are not expressly regulated by the SCO, and contractual penalties (*Konventionalstrafe*, *peine conventionnelle*) within the meaning of Art. 160 et seq. SCO. It also clarified the scope and effect of liquidated damages clauses.

By way of reminder, a contractual penalty clause requires the debtor to pay a lump sum to the creditor in the event of a breach of contract, irrespective of whether the conditions of contractual liability are met, whereas a liquidated damages clause predetermines the amount of damages recoverable under rules governing contractual liability.[1]

The scope and effect of liquidated damages clause are disputed among legal scholars. The Federal Supreme Court noted three views: (i) the liquidated damages clause affects the burden of proof only with respect to the quantification of damages, while the creditor must still prove that damages occurred; (ii) the liquidated damages clause relieves the creditor from proving both the occurrence and the quantification of the damages; and (iii) the liquidated damages clause relieves the creditor from proving the damages, but they must still substantiate the damages.

The Federal Supreme Court did not endorse any of the above-mentioned views. Instead, it emphasized that, as a matter of principle, a liquidated damages clause neither per se relieves the creditor from proving that damages have occurred, nor does it impose on the creditor an obligation to do so. The parties to a contract are free to allocate the burden of proof and factual allegation within the scope of their contractual freedom. Accordingly, the scope and effect of a liquidated damages clause must be determined through contract interpretation.

In the case at hand, the Federal Supreme Court held that the parties intended to release the Supplier not only from proving the amount of damage, but also from proving that any damage had occurred, while preserving the Client's right to demonstrate that no damage was incurred. This conclusion followed from the parties' agreement that the Client would be required to pay liquidated damages to the Supplier after completion of the stipulated formal escalation process. The parties further specified that the liquidated damages were intended to cover both actual damages and expected losses, which were impossible or difficult to quantify, and that such liquidated damages were intended to serve as compensation rather than a penalty.

The scope and effect of a liquidated damages clause or a contractual penalty clause ultimately depends on the parties' agreement. When drafting an agreement, it is essential to clearly specify whether a clause is intended to be a liquidated damages clause or a contractual penalty clause. While both types of clauses concern the enforcement of monetary obligations that may arise from a debtor's breach of contract or other liability events, their purposes differ fundamentally.

A liquidated damages clause has a compensatory function. By stipulating such a clause, the parties predetermine the amount that the debtor shall pay to compensate for damages arising from a specific liability event. In order for the creditor to obtain payment under a liquidated damages clause, the conditions of contractual liability must be met: the debtor must have committed a wrongful breach of contract that caused damage to the creditor, and the breach and damage must be linked by a natural and adequate causal relationship.

The burden of proof can be allocated freely by the parties in their contract. It is important to state expressly whether the

clause relieves the creditor from proving both the occurrence and the amount of damage, while preserving the debtor's right to prove the absence of damage. Particular care must be taken to avoid any confusion between liquidated damages clauses and contractual penalty clauses. As noted by the Federal Supreme Court, if the debtor's right to prove the absence of damage is excluded, the clause qualifies as a contractual penalty.

By contrast, a contractual penalty clause has a punitive purpose. It entitles the creditor to claim the stipulated amount upon occurrence of a specified event (such as a breach of contract), irrespective of whether the conditions of contractual liability are met. In particular, the creditor may enforce the penalty even without having suffered any damage, and the debtor cannot be released by proving the absence of damage.[2]

In both cases, the creditor may, as a rule, still claim additional damages if the actual loss exceeds the agreed amount provided for in the liquidated damages or contractual penalty clause.[3] Moreover, the court (or arbitral tribunal, as applicable) may reduce any such amount if it is deemed excessive in relation to the actual damages suffered by the creditor.[4]

When stipulating a contractual penalty, the parties are well advised to specify clearly whether the penalty clause is (i) alternative, allowing the creditor to claim either performance of the secured obligation or payment of the penalty, (ii) cumulative, allowing the creditor to claim both performance of the secured obligation and payment of the penalty, or (iii) exclusive, whereby the creditor may claim only payment of the penalty, to the exclusion of performance.[5]

Other comments on this judgment

Borel & Barbey, Swiss Supreme Court clarifies the burden of proof in the context of liquidated damages clauses, https://www.borel-barbey.ch/en/swiss-supreme-court-clarifies-the-burden-of-proof-in-the-context-of-liquidated-damages-clauses/

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Philipp H. Haberbeck, Linkedin Post https://www.linkedin.com/posts/philipphaberbeck_sft-4a5262024-activity-7339277566148554754-WTi

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Raphael Riedo, BGer-Urteil 4A_526/2024 vom 28. April 2025 zu vertraglich pauschalisierten Schadenersatzansprüchen, *in* : bratschi zivilprozessrecht blog, Oktober 2025, https://www.bratschi.ch/publikationen/zivilprozessrecht-blog-bger-urteil-4a-526-2024-vom-28-april-2025-zu-vertraglich-pauschalisierten-schadenersatzanspruechen

Wenger Plattner, Wenger Plattner klagt erfolgreich Liquidated Damages vor Handelsgericht Zürich ein und wehrt danach auch Beschwerde vor Bundesgericht ab, https://wenger-plattner.ch/de/news-insights/wenger-plattner-klagt-erfolgreich-liquidated-damages-vor-handelsgericht-zurich-ein-und-wehrt-danach-auch-beschwerde-vor-bundesgericht-ab/

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[1] See Sylvain Marchand, Clauses contractuelles, Du bon usage de la liberté contractuelle, Basel (Helbing Lichtenhahn) 2008, pp. 214 et seq.; Alborz Tolou, La forfaitisation du dommage, Thèse, Zurich (Schulthess) 2017, N 107 et seq. and 208 et seq.

[2] See Tolou, op. cit., N 172.

[3] See Tolou, op. cit., N 173.

[4] See Judgment of the Federal Supreme Court of 19 April 2016, 4A_601/2015, reason 2.3.3.

[5] On those notions, see Marchand, op. cit., pp. 213 et seq.; Tolou, op. cit., N 166 et seq.

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