A Rare and Remarkable Decision by the Swiss Federal Supreme Court on General Terms and Conditions

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Key takeaways

- An invoice dispute mechanism and a contractual penalty provided for in General Terms and Conditions in a business-to-business setting were declared invalid by the Federal Supreme Court due to unusualness.
- Unfamiliarity with a certain industry suffices for the rule of the unusual to apply. Notably, the rule's applicability is not limited to cases where a "weak" and a "strong" party are facing each other, as is typically the case in employment contracts.
- The Federal Supreme Court, on its own initiative, addressed the clauses declared invalid, although none party had pleaded so.

What was the case about?

Z Ltd ("IT-Provider") entered into three contracts with A Ltd ("Customer") on 12 December 2016: a software license agreement, an IT services agreement, and a maintenance agreement. Each of the contracts contained specific General Terms and Conditions ("GTC"). Art. 6 of the GTC supplementing the IT services agreement contained clauses with the following content (freely translated and summarized):

- The Customer may make a duly substantiated reservation of services within a maximum period of 30 days in the form of a registered letter, with acknowledgement of receipt after the invoice has been issued, for all or part of the services on the invoice. ("invoice dispute mechanism").
- The Customer undertakes to pay a fixed indemnity of CHF 107'289 if he terminates the contract for whatever reason without fault on the part of the IT-Provider. ("termination penalty").

The Customer terminated the three contracts in February 2019 with immediate effect, alleging budget overruns and IT vulnerabilities. The IT-Provider denied such allegations and, in turn, requested the payment of almost CHF 200'000 (roughly CHF 90'000 for unpaid invoices and roughly CHF 110'000 as contractual penalty), the return and destruction of the software, as

well as a daily penalty payment for the unauthorized use of the software until its return. The cantonal court Freiburg, as the only cantonal instance, decided that the Customer must pay the requested amount but denied the daily penalty payment for an unauthorized use of the software. The Customer appealed the decision to the Federal Supreme Court.

The Federal Supreme Court's findings

The rule of the unusual continues to apply in B2B settings

In its decision 4A_372/2022 of 11 July 2023, the Federal Supreme Court dealt with the rule of the unusual and assesses whether the clauses in Art. 6 GTC are to be considered as unusual and, therefore, invalid.

According to the rule of the unusual, a blanket consent to GTC does not cover the GTC's unusual clauses, unless the party authoring the GTC did specifically bring such unusual clauses to the attention of the commercially inexperienced party. In other words, the GTC's drafter must expect that the inexperienced party to the contract would not have agreed to such unusual clauses. In a constellation with two commercial companies, one can hardly speak of a "strong" and a "weak" party. According to the Federal Supreme Court, the rule of the unusual is, however, not limited to cases where a "weak" and a "strong" party are facing each other, as is typically the case in employment contracts. Unfamiliarity with a certain industry suffices.

Invalidity of Art. 6 GTC due to unusualness

The invoice dispute mechanism in question required the customer to raise any objections to invoices within 30 days of its receipt in the form of a registered letter with acknowledgement of receipt, failing which the invoice would be deemed accepted. In its decision, the Federal Supreme Court found that such a clause is unusual. The IT-Provider was specialized in IT and therefore familiar with the specifics of IT contracts, in contrast to the Customer, who only needed software to run its business but was otherwise not familiar with the IT services industry. The Federal Supreme Court found that such an invoice dispute mechanism significantly impairs the legal position of the Customer, as it would be forced to settle the invoices if it does not respond within the prescribed period and format.

In a next step, the Federal Supreme Court analyzed the termination penalty, according to which the Customer had to pay a contractual penalty of roughly CHF 110'000 in the event of termination of the contract for whatever reason other than for the IT-Provider's fault.

According to the Federal Supreme Court, also this termination penalty provision significantly impairs the legal position of the Customer and should therefore be qualified as an unusual clause. It is noteworthy that the Federal Supreme Court did not analyze the termination penalty in light of the principles of contractual penalties under Swiss law but declared the whole clause as unusual in general terms and condition and, thus, invalid.

Due to the unusual nature of the above-mentioned clauses of Art. 6 GTC, the Federal Supreme Court declared both the invoice dispute mechanism and the termination penalty invalid. Therefore, the invoices, against which the Customer had not raised an objection within the required 30 days, were not automatically deemed accepted. Likewise, the Customer was not

obliged to pay the termination penalty of roughly CHF 110'000.

Unpaid invoices – entitlement to payment denied

In addition to the termination penalty, the IT-Provider claimed from the Customer roughly CHF 90'000 for unpaid invoices. Based on the burden of proof, it is the IT-Provider's duty to prove that the services justifying such a claim have indeed been provided. However, the IT-Provider's submission in front of the court of first instance in this regard were limited, as it relied on its invoice dispute mechanism and the incontestability of the invoices. It assumed that the Customer would have to pay the invoices irrespective of any additional need of the IT-Provider's proof, due to the lack of the Customer's timely objection against the invoices in question.

Considering that Art. 6 GTC is invalid, the Federal Supreme Court found that the IT-Provider's pleadings in front of the lower court were inadequate. Since the Customer claims for unsatisfactory service provision, it was the IT-Provider's duty to prove which contractual obligations it had fulfilled and for which remuneration. As the IT-Provider had neither asserted nor proven the specific service provision, giving rise to its alleged claim, the Federal Supreme Court denied its entitlement to the invoices' payment.

Why is this case important?

Judicial control of GTC in a business-to-business setting

Please note that the comments on GTC and their validity refer to a case in a business-to-business setting. Judicial control of General Terms and Conditions is rarely seen in Switzerland, even less in a business-to-business setting. Hence, this decision should serve as a reminder also for parties dealing in a mere B2B setting that they must highlight unusual clauses and may not blindly rely on their enforceability, all the more so when their counterparty is not familiar with this industry.

Unusualness of the GTC clause instead of the reduction of the contractual penalty

A contractual penalty serves as a safeguard for fulfilling contractual obligations. Typically, such penalties involve fines imposed if a party fails to meet a certain obligation. In the absence of any other agreement, the creditor generally has the option to demand either performance or the contractual penalty. The judge may reduce the contractual penalty, however, if it is deemed excessive (Art. 163 para. 3 CO). The possibility of reduction is mandatory, i.e., contractual parties cannot exclude such judicial review. The Federal Supreme Court decided to declare invalid Art. 6 GTC including the contractual penalty instead of reducing the amount of the contractual penalty, according to Art. 163 para. 3 CO. In light of this decision, drafters of GTC should, even more carefully, consider whether including contractual penalties is appropriate.

Judicial scrutiny of the invoice dispute mechanism although not pleaded by either party

Although the Customer did not directly claim that Art. 6 GTC was unusual (it pleaded that another provision was unusual), the Federal Supreme Court addressed this topic on its own initiative. This, once again, sheds light on the importance of establishing the service provision

underlying the alleged claim if the counterparty disputes such service provision or its quality.

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No legal or tax advice

This legal update provides a high-level overview and does not claim to be comprehensive. It does not represent legal or tax advice. If you have any questions relating to this legal update or would like to have advice concerning your particular circumstances, please get in touch with your contact at Pestalozzi Attorneys at Law Ltd. or one of the contact persons mentioned in this legal update.

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