

Company & Commercial - Switzerland

Personal liability of board members for abusive lawsuits

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June 10 2013

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Executive summary

In a 2012 case, the Federal Supreme Court held that lawsuits brought by the board on behalf of a Swiss company limited by shares against minority shareholders entailed the personal liability of the board members pursuant to Article 754 of the Code of Obligations, because the board had breached its duty to treat all shareholders equally regarding their entry in the share register. This was characterised as an abuse of law that triggered such personal liability.⁽¹⁾

First decision

In 1989, the shareholders of Y Beteiligungen AG, a Swiss company limited by shares, were split into two major groups. The majority shareholders held 52% of the shares, while the minority shareholders (including X AG and Z AG) held only 47%. In 1998, X and its subsidiary Z merged. Consequently, X requested Y's board to become registered as the holder of the former Z shares in Y's share register, but the board denied.

In July 1999, X started proceedings for registration of the former Z shares in the share register of Y. The registration request was denied by Y's board and taken to the Supreme Court (the first Supreme Court decision), which held that:

- non-registration of the minority shareholder X in the share register of Y infringed the obligation of Y's board to treat all shareholders equally;
- it was not in the best interests of Y; and
- it had to be characterised as an abuse of the institute of restricted shares with limited transferability under Swiss company law.

Second decision

Consequently, in 2003 X also initiated proceedings for personal liability against Y board members, arguing that the abuse of law had caused damage to Y. It requested around Sfr1.275 million in damages payments from the board members, pursuant to Article 754 of the Code of Obligations, which reads as follows:

"The members of the board of directors and all persons engaged in the business management or liquidation of a company are liable both to the company and to the individual shareholders and creditors for any losses or damages arising from any intentional or negligent breach of their duties."

Having been held personally liable by the lower Swiss courts, the board members appealed to the Supreme Court, which upheld this decision and confirmed the personal liability of the board members for abusive litigation on behalf of Y (the second Supreme Court decision). The court first confirmed that X, as shareholder, was entitled to claim the payment of damages to Y from the board members, distinguished in Article 754 - which differentiates between indirect damages (ie, damages inflicted on a Swiss company) and direct damages directly inflicted on a shareholder. In this case, the damages were indirect damages (the court and attorney fees to be paid by Y to X after losing the first decision).

The court highlighted certain legal obligations of Swiss company board members, as follows:

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- Article 717 of the Code of Obligations requires that board members safeguard the interests of a Swiss company in good faith.
- In this regard, the court confirmed that board members of a Swiss company cannot apply only the standard of care that they use for their own affairs, but in fact owe the company all due care of an impartial person in a comparable situation who has the necessary information and knowledge to make the decision at issue.
- Board members must act in a way which they consider - in the economic circumstances of a particular case - to be in the best interests of a Swiss company (ie, they may not pursue court proceedings which they know in advance to be without merit).
- Additionally, board members may not take any action which they know to be in the interests of one shareholder group only, but must instead treat all shareholders equally.

In this case, during the proceedings, the board members had admitted that the reason for their decision not to register X in Y's share register was to avoid the minority shareholder X influencing any decision making in Y. However, the board members failed to present any evidence proving that they had good reason to expect that the influence of X as a shareholder of Y could be detrimental. In the absence of such evidence, the board members should have had the foresight to see that they had no legitimate reason under applicable company law to deny X registration as a shareholder in the share register.

The second Supreme Court decision addressed the issue of whether the first Supreme Court decision - which had confirmed an abuse of law by the board members in the interests of the majority shareholder group - had also led automatically to a characterisation of the related court proceedings of the board as an abuse of law. In the second decision the court held that even if a Swiss court finds that an abuse of law has arisen in a particular case, it cannot be concluded automatically that the litigation also constitutes an abuse of law. Instead, this issue must be assessed on a case-by-case basis. The question is always whether the risks were economically unjustifiable at the time before legal proceedings were started by the board (ie, not only on a hindsight bias).(2)

The court did not accept as an excuse the two expert opinions of eminent Swiss law professors presented by the board members which had come to the (wrong) conclusion in the first decision - that Y's board would be entitled to deny registration of X in the share register. Instead, the court held that those expert opinions did not address the abuse of law issue at all (and as a result, could not exclude the personal liability of the board for such abuse of law). In a similar case, the court even stated explicitly that legal advice is insufficient to show that court proceedings initiated by the board on behalf of a company are carried out in good faith (unless the advice is specifically requested to assess and evaluate the personal liability risks in the case at hand).(3)

In summary, the second decision concluded that the proceedings initiated by the board against X were:

- not in the best interests of the company;
- against good faith; and
- an abuse of law.

The board members of Y should have been aware that the procedural risks at stake were exceptionally high in the circumstances.

As a result, the board was regarded to have negligently breached its duty of care and loyalty under Article 717 against good faith, making the board personally liable for the indirect damages caused to Y.

Comment

Lawsuits involving the personal liability of board members usually arise in Switzerland when a company is liquidated. Nevertheless, diligent board members of Swiss companies would be well advised to minimise their personal liability before launching lawsuits on behalf of the company by consulting an experienced lawyer in advance regarding the related personal liability risk. The consultation should not be limited to a mere assessment of legal issues, but should also include whether a claim on behalf of the company has merit, based on all circumstances of the case. The legal advice sought must thus be comprehensive and include the assessment of a potential abuse of law, in particular in situations which potentially run against the interests of single shareholders or shareholder groups.

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Endnotes

- (1) Swiss Federal Court decision, 139 III 24.
- (2) Swiss Federal Court decision, 4A_74/2012.
- (3) Swiss Federal Court decision, 139 III 24.

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