

New Federal Court decision on business judgement rule

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Introduction

A recent Swiss Federal Court decision⁽¹⁾ clarified the circumstances under which the personal liability of board members or managers of a Swiss company for their business decisions and omissions can be reduced by applying the so-called 'business judgement' rule or, if the related prerequisites are not met in a particular case, based on other grounds.

The Federal Court held that even in cases where the business judgement rule provides no safe harbour for board or management decisions, it is still possible that such decisions might not constitute breaches of duty entailing the personal liability of the board and management members of the company at issue. This may be the case if a particular decision can – based on all relevant circumstances of a particular case – be regarded as reasonable from an impartial business perspective.

Business judgement rule in Switzerland

Under pre-existing Swiss federal court practice, the business judgement rule applies if business decisions of the board or management of a Swiss company must be examined as to whether they breached personal duties. In this respect, two different scenarios may exist:

- In the first scenario, a board member or manager acted:
 - in compliance with all applicable procedural rules for board or management decisions (ie, with proper process);
 - on an informed basis (ie, taking into account all material information which was or could reasonably be gathered in advance); and
 - without any conflict of interest among the participating members or managers (ie, abstentions from anyone with a personal interest in the matter, including personal interests of relatives or affiliated entities).

In such cases, the Swiss courts must examine only whether a particular decision or failure of the single board member or manager to act was "justifiable" based on all circumstances of the particular case.

- In the second scenario, the above three prerequisites are not met and thus the Swiss courts must then examine not only whether a business decision or failure was justifiable, but also whether it passes the (harder) impartial reasonability test based on all the relevant circumstances.

Facts

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Swiss company F AG was in the business of re-filling and selling spring water in gallon bottles under a cooperation agreement with spring water company U AG. F AG's board of directors had four members, including the claimant referred to as A. After claimant A had decided himself to start a re-filling business with B AG, he was removed from F AG's board of directors in June 2007 but remained a shareholder of F AG.

In October 2008 F AG started liquidation proceedings after an important F AG client switched to become a customer of claimant A's new company. F AG sold its water filling machine and its gallon bottles to another company referred to as G AG for a purchase price of roughly Sfr27,000 in cash, plus the assignment by F AG and a takeover by G AG of F AG's contractual filling obligations towards U AG.

Claimant A argued that the filling machine (and the gallon bottles) could have been sold for a better purchase price but were instead sold to G AG because several members of F AG's board of directors also had a business interest in G AG. Claimant A alleged that these board members were in a conflict of interest and, as a result, breached their personal duty of care as board members of the F AG with the sale.

Federal Court decision

The Federal Court first confirmed its previous decisions concerning the business judgement rule. As several board members were involved in both F AG and G AG, they obviously had a conflict of interest regarding the sale of the filling machine. As a result, the Federal Court examined not only whether the decision to sell to G AG was justifiable, but also whether it passed the impartial reasonability test based on all the relevant circumstances.

The Federal Court concluded that F AG's board members had not breached their duty of care on the grounds that even though the filling machine and gallon bottles alone might have been sold at a higher price, the sale to G AG was reasonable from an impartial business perspective because it saved F AG additional costs in connection with the otherwise necessary dismantling of the filling machine and the breakage costs resulting from the premature termination of its cooperation agreement with U AG (estimated at roughly Sfr50,000) since G AG also undertook to keep the filling machine in the same place and comply with the terms and conditions of the cooperation agreement with U AG. These otherwise necessary higher costs could thus be added to the lower sale price of the filling machine, as in the circumstances it was unlikely that – apart from G AG – another buyer would have been found to have kept the machine in the same place and have taken over the cooperation agreement with U AG.

As a result, the court also held that F AG's board:

- was under no legal obligation to have the water filling machine appraised by a third-party expert or to organise competing offers before the sale to G AG; and
- was entitled to liquidate F AG after the sale because F AG could no longer be competitive, having lost its biggest filling client to claimant A's new company B AG.

Comment

Thus, Swiss board and management members may not become personally liable for decisions or failures to act which are reasonable from an impartial business perspective even if there was a conflict of interest situation in the particular case, as a result of which the business judgement rule could not be applied.

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Endnotes

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