International Law Office

Liability of directors and board members in corporate groups

14 December 2020 | Contributed by Badertscher Attorneys at Law

AUTHORS

Stefan Jud

Markus Dörig

In practice, most large companies are structured as corporate groups. Corporate groups are recognised and in certain areas regulated by Swiss law (eg, accounting). However, there is little case law discussing the characteristics of corporate groups, particularly the liability of group executives. In a recent decision in the context of the collapse of the Swissair Group in 2001, the Federal Supreme Court commented on the liability of directors and board members in corporate groups.

Facts

In the late 1990s, Switzerland's national airline Swissair was transformed into a group structure in which SAirGroup AG acted as the group holding company, while Swissair Schweizerische Luftverkehr-Aktiengesellschaft (Swissair), a subsidiary of SAirGroup, was responsible for flight operations. Further, in order to ensure group-wide liquidity, a zero balancing cash pooling was introduced in which the Dutch SAirGroup Finance (NL) BV (Finance BV) acted as pool leader.

In the cash pooling system, Swissair was usually a net creditor of Finance BV. In addition, Swissair granted various fixed-term loans to SAirGroup. When the entire Swissair Group collapsed in 2001, Swissair incurred high losses due to defaults on its cash pool claims against Finance BV and the default of several fixed-term loans to SAirGroup.

In 2013 Swissair's liquidators initiated action before the Zurich Commercial Court against several former directors and board members of SAirGroup, accusing them of having:

- introduced an illegal group organisation (through which Swissair lost its financial independence); and
- breached their duties in managing Swissair's assets by participating in the cash pooling and granting loans to SAirGroup.

In March 2018 the Zurich Commercial Court dismissed the action. In November 2019 the Federal Supreme Court confirmed the Zurich Commercial Court's decision (Decision 4A_268/2018 of the Federal Supreme Court from 18 November 2019, unpublished). With regard to the liability of directors and board members, the following considerations of the Federal Supreme Court decision are worth unpacking.

Decision

As regards the allegation of having introduced an illegal group organisation, the Zurich Commercial Court stated that the subordination of subsidiaries in groups inevitably requires the group holding to manage and control the subsidiaries. The Zurich Commercial Court further acknowledged that this necessity of controlling subsidiaries clearly conflicts with (legal) independence and the principle of self-administration of subsidiaries, thus creating a so-called 'group paradox' with respect to the duties of directors and board members of group subsidiaries. While there are different concepts in Swiss legal doctrine about how to deal with this paradox, the Zurich Commercial Court followed the so-called 'subordination concept',(1) according to which the non-transferable and inalienable duties of board members under Swiss corporate law(2) are reduced for board members of subsidiaries. As a result, such board members are left only with residual competencies.(3) Unfortunately, the Federal Supreme Court did not further discuss the Zurich Commercial Court's considerations in this regard. Therefore, the extent of legally permissible subordination remains unclear to a certain degree. However, the decision also contains no indication that the Federal Supreme Court did not follow the Zurich Commercial Court's considerations and thus the subordination concept.

The key element of the decision lies in the Federal Supreme Court's considerations regarding the alleged breaches by the SAirGroup executives in managing Swissair's assets. In this context, the Federal Supreme Court concluded that management decisions which violate the capital protection provisions in Swiss corporate law(4) – in the case at hand, the granting of loans which are not at arm's length to other group companies – may be justified in special circumstances. Such special circumstances may exist if the granting of a loan ultimately is in the lender's interest. The Federal Supreme Court expressly acknowledged that a subsidiary, which is dependent on other group companies for continuing its own business operations, may have an eminent (indirect) interest in the continued existence of the entire group. Therefore, the Federal Supreme Court concluded that in view of a subsidiary's advantages of being part of a corporate group, the group's interests must also be considered to a certain extent when assessing the admissibility of business decisions taken in subsidiaries (and thus, when assessing the potential liability of the directors and board members of such subsidiaries).(5)

Finally, the Federal Supreme Court held that Swissair's fixed-term and cash pool loans were considered operational investments rather than pure financial investments, since in the Swissair Group, these loans could also be used indirectly in the interest of Swissair. The Federal Supreme Court confirmed that in accordance with the business judgement rule, the courts are limited when reviewing such operational investments.(6)

Comment

The Federal Supreme Court's decision does not change the principles that apply to the liability of directors and board members under Swiss corporate law. Directors and board members of group subsidiaries must still act in the interest of the respective subsidiary. However, the Federal Supreme Court confirmed for the first time that the advantages of being part of a corporate group may also be taken into account when determining the interest of a subsidiary. These advantages will regularly lead to the conclusion that it is in the subsidiary's own interest to pursue (or at least consider) the interests of the group.

This development in case law is welcomed. The Federal Supreme Court's decision confirms the admissibility of cash pooling and, more generally, of intra-group financing (eg, up and cross-stream loans). As such, the decision provides directors and board members in corporate groups with the necessary flexibility for entrepreneurial – and thus naturally risky – decisions, particularly with regard to intra-group financing. However, whether intra-group loans or cash pooling systems meet all of the relevant requirements of Swiss corporate law remains dependent on the circumstances of the individual case. Therefore, it is still strongly recommended to have such intra-group financing decisions legally reviewed.

For further information on this topic please contact Stefan Jud or Markus Dörig at BADERTSCHER Rechtsanwälte AG by telephone (+41 44 266 20 66) or email (jud@b-legal.ch or doerig@b-legal.ch). The BADERTSCHER Rechtsanwälte AG website can be accessed at www.b-legal.ch.

Endnotes

(1) See Peter Böckli, Schweizer Aktienrecht, 4th ed 2009, Section 11, Paragraph 298 *et seq*; see also Christoph B Bühler in *Zürcher Kommentar*, 3rd ed 2018, Article 716a OR, Paragraph 155; Peter and Cavadini in *Commentaire romand, Code des obligations II*, 2nd ed 2017, Article 716a OR, Paragraph 45 *et seq*; Roland von Büren, *Der Konzern, SPR Bd VIII/6*, 2nd ed 2005, p62 *et seq*.

(2) See Article 716a, Paragraph 1 of the Code of Obligations.

(3) Federal Supreme Court, 4A_268/2018, consid 6.4.

(4) Prohibition of hidden profit distribution (see Article 678, Paragraph 2 of the Code of Obligations) and prohibition to return capital contributions (see Article 680, Paragraph 2 of the Code of Obligations).

(5) Federal Supreme Court, 4A_268/2018, consid 6.5.4.4.

(6) Federal Supreme Court, 4A_268/2018, consid 6.5.4.4.