Dear clients and business friends,

In the context of litigation involving liability under the law on companies limited by shares, courts are required to answer the question of whether and to what extent corporate bodies have acted in breach of their obligations and can be held liable for any resulting financial damage. This question is particularly sensitive in cases where business decisions taken by the board of directors or the management board have turned out to be wrong. It would be problematic if a court were to subsequently deem a business decision by the governing bodies as being in breach of their obligations for the sole reason that the business decision in question turned out, in retrospect, to have been wrong or inexpedient.

Following the doctrine developed in US case law, referred to as the “Business Judgment Rule”, the Swiss Federal Supreme Court has, in its most recent judicature, thus identified the criteria in the presence of which the content matter of business decisions should only be further treated with reserve. The requirements for applying the Business Judgment Rule centre on whether a business decision was taken within the appropriate procedures. Despite being called such, the Business Judgment Rule is not a clear “rule” that prescribes a systematic exploratory approach.

1. Liability of Corporate Bodies for Business Decisions

Pursuant to Art. 754 (1) CO the members of the board of directors and all persons engaged in the business management or liquidation of the company are liable both to the company and to the individual shareholders and creditors for any losses or damage arising from any intentional or negligent breach of their duties (liability of corporate bodies under civil law).

In the context of litigation involving the liability of corporate bodies, the question often arises as to how failed business decisions should be judged by the courts. The mere fact that a business decision turned out to be wrong or inexpedient and resulted in financial damage cannot lead one to conclude that the decision-maker is guilty of a breach of his obligations in such a way that this would cause him to be liable.

Business decisions take place in the context of executive decision-making autonomy and are thus of a “business-policy” nature; this in contrast to decisions which are based on statutory legal provisions (e.g. the obligation to prepare an annual financial statement). Business decisions are based on a weighing up of opportunities and risks and must often take place under time pressure on the basis of incomplete information. The subsequent judicial review of business decisions entails the risk of falling prey to a systematic error in reasoning referred to as hindsight bias. In retrospect events often seem more predictable than they were at the time – “Hindsight is easier than foresight”.

The doctrine known as the “Business Judgment Rule” developed by US courts seeks to counter such hindsight bias. It requires that restraint be exercised in the judicial review of business decisions under certain circumstances and in doing so protects the ability of governing bodies to exercise their decision-making prerogatives. Governing bodies should be afforded the necessary discretionary room to manoeuvre when acting and taking decisions in the exercise of their duties. Courts should not replace the discretion of corporate bodies with their own.

2. The “Swiss” Business Judgment Rule

In 2012 the Swiss Federal Supreme Court for the first time explicitly recognized, in concurrence with the majority of legal scholars, “that the courts must exercise restraint when retroactively reviewing business decisions, which were based on unobjectionable and adequate information and were taken in the context of decision-making processes free of conflicts of interest” (Judgments of 18 June and 20 November 2012 re business decisions).
granting credit to an over-indebted subsidiary and to prosecuting legal action in the interest of the majority shareholder).

Despite the fact that the Swiss Federal Supreme Court avoids the use of the English-language term, a Business Judgment Rule of a “Helvetian persuasion” can be seen. In contrast to the normal approach taken in the context of liability claims, under the aforementioned conditions – described in more detail below – there is no comprehensive substantive review of the business decision, but rather deference to the prerogatives of the business discretionary autonomy of the decision-makers.

3. Approach when Reviewing Business Decisions

Based on the current judicature of the Swiss Federal Supreme Court, when reviewing failed business decisions by the executive management bodies, the following criteria are to be examined:

1. Is one in the presence of a business decision? – In the event one is not dealing with a business decision (but rather e.g. a legal obligation), the court reviews the action or omission with unconstrained discretion.

2. When taking the business decision, was the corporate body acting under a direct conflict of interest (e.g. in that specific, individual, personal interests or interests of third persons stood juxtaposed to the interests of the company)? – If yes, a presumption arises that fiduciary obligations have been breached and the business decision is reviewed with unconstrained discretion, provided the decision-makers are unable to demonstrate that in the case in question, any risk of disadvantaging the company was excluded (e.g. as a result of subjecting the decision to the approval of the general shareholders’ meeting or by obtaining an objective and independent fairness opinion or a valuation report).

3. Is the rationale for the decision comprehensible, i.e. was the decision taken in the context of a careful deliberative process and in particular on the basis of what, given the specific circumstances, could be deemed sufficient information (in particular on the basis of prior investigations and corresponding documentation)? In other words: Is it possible to comprehend how the decision was taken and is it possible to understand why the decision was taken? – In the event that this central questions must be answered in the negative, the court is released from the requirement to show deference when reviewing the substance of the decision.

4. Is the outcome of the business decision untenable, given that it conflicts with the interests of the company, or because the degree of business discretion was clearly exceeded? – In the event that the decision was untenable, there is a presumption that the decision-makers committed a breach of their obligations. In as much, a substantive review of the business decision takes place.

In the aforementioned “leading cases” dated 18 June and 20 November 2012, the Swiss Federal Supreme Court came to the conclusion that the executive management decisions were based on erroneous information (see criterion 3) or where not in the interest of the company (see criterion 4) and could thus be categorized as a breach of due diligence or fiduciary obligations (Art. 717 (1) CO).

4. Additional Comments

A breach of mandatory statutory provisions constitutes an independent breach of obligations that gives rise to a persons liability, and which cannot be justified by making reference to the business discretion of the acting bodies (e.g. where the board of directors of an unambiguously over-indebted company fails to act in breach of Art. 725 (2) CO over a period of months and neither enacts restructuring measures nor notifies its balance statement with the bankruptcy court). The above criteria for deference when reviewing business decisions thus does not apply when reviewing a breach of mandatory law.