In brief: directors' and officers' liability for company insolvencies in Switzerland

Switzerland | November 10 2020

Directors and officers

Directors' liability – failure to commence proceedings and trading while insolvent

If proceedings are not commenced, what liability can result for directors and officers? What are the consequences for directors and officers if a company carries on business while insolvent?

The members of the board of directors and all persons engaged in the management or liquidation of the company, as well as all persons engaged in the audit of the annual account, are liable not only to the company, but also to the shareholders and to the company's creditors for the damage caused by an intentional or negligent violation of their duties, for which a disregard of the provisions set out in article 725 of the Code of Obligations is being considered. The provisions regarding liability (Code of Obligations, articles 752 to 760) also apply to the founders, organs or supervisors of banks.

As a further consequence, certain transactions conducted by the company while insolvent may be the subject of avoidance actions (Debt Collection and Bankruptcy Act (DCBA), article 287) to refer the assets in question to the estate.

Criminal liability may eventually occur for acts that are conducted fully aware that the company will not be able to pay its debts.

Directors' liability – other sources of liability

Apart from failure to file for proceedings, are corporate officers and directors personally liable for their corporation's obligations? Are they liable for corporate pre-insolvency or pre-reorganisation actions? Can they be subject to sanctions for other reasons?

For legal entities in general, their liabilities have to be satisfied by their own assets. The personal liability of corporate officers and directors arises only in the context of a violation of their duties. This also applies to governmental claims, in particular to the non-payment of social security contributions or withholding of taxes.

Article 754 of the Code of Obligations provides that members of the board of directors or persons entrusted with the management or liquidation of the corporation is liable for any damage caused to the corporation, its shareholders or creditors where they have intentionally or negligently acted in breach of their duties. This responsibility applies not only to the formally appointed representatives, but also to what are termed 'factual corporate bodies' (all persons who in fact decisively influence the corporate decision-making process). The

principles of fiduciary duties are specified in a number of statutory provisions that aim to protect the shareholders' as well as the creditors' interests. Further specifications are set forth in the company's by-laws and organisational rules.

Of particular interest is article 725 of the Code of Obligations. Lastly, the Swiss Penal Code sanctions reckless bankruptcy or mismanagement.

Directors' liability – defences

What defences are available to directors and officers in the context of an insolvency or reorganisation?

Directors and officers can benefit from five means and defences to reduce their liability:

- First, they only incur liability if the following prerequisites are met: damage, breach of duty, causal nexus and fault. Objecting to fault, however, is challenging as it is based on objective criteria and unaffected by the obedience to shareholder instructions.
- Second, to reduce the risk of liability, directors and officers are advised to comply with corporate law and to take adequate action and precaution, especially with regard to the protection of corporate assets and to mandatory action in case of over-indebtedness.
- Third, courts generally exercise restraint in reviewing corporate decisions if the latter result from a sound decision-making process, are based on pertinent information and made in the absence of conflicts of interests ('business judgement rule'). In this context, courts examine these requirements in an objective manner, do not consider alternatives for action and rule only in cases of conduct that is relevant to criminal law or clearly in the interest of the respective director or officer.
- Fourth, directors and officers do not incur liability for decisions to which they opposed in a substantiated and recorded manner.
- Fifth, they can benefit from directors' and officers' insurance, which, tailored to their function and context, protects their private assets against liability and defence costs.

The following two general defences, however, are only partially available in the context of insolvency and reorganisation:

- First, discharge granted by a shareholders' meeting is only effective towards claims by those who granted it. As a result, claims by creditors and by the bankruptcy administrator remain unaffected.
- Second, indemnification agreements prevent liability if entered into by (individual) shareholders. Yet, it is contested whether they do so if entered into by the company itself.

Shift in directors' duties

Do the duties that directors owe to the corporation shift to the creditors when an insolvency or reorganisation proceeding is likely? When?

If the duties are not observed by the directors or if they support actions that are subject to challenge, personal liability to the creditors can ensue. The duties of the board relate to the specific company on a stand-alone basis only. The company's interests have to be defined according to the prevailing circumstances (essentially following business judgement). Swiss corporate law is based on the notion that each legal entity has to protect and pursue its own interests. Cash management is of particular interest.

Directors' powers after proceedings commence

What powers can directors and officers exercise after liquidation or reorganisation proceedings are commenced by, or against, their corporation?

Under the supervision of the commissioner and at the direction of the composition court, the debtor may continue its business operations. However, certain transactions will require approval from the court or the creditors' committee, if appointed. The debtor is prohibited to divest, encumber or pledge fixed assets, to give guarantees or to donate assets without the authorisation of the composition court or the creditors' committee, respectively. Moreover, if the debtor contravenes the commissioner's instructions, the court can revoke the debtor's capacity to dispose of its assets or declare bankruptcy. At the discretion of the court, the authority to operate the business can be given to the commissioner. The court may deprive management of its power of disposal or make its resolutions conditional on the commissioner's approval. Contracts entered into during the moratorium with the commissioner's approval enjoy priority over pre-petition rights. Unless a creditors' committee is appointed, which is one of the new features of the revised DCBA, the role of the creditors during the entire proceeding is fairly passive. They have to file their claims, can attend the creditors' meeting, can approve or reject the proposed composition agreement and have the right to be heard in court.

Law stated date

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26 October 2020.

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