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Swiss Supreme Court confirms its case law on self-dealing transactions

I. INTRODUCTION

The issue of self-dealing transactions commonly arises in cases of legal representation of a legal entity by its corporate bodies, in particular when a company enters into a transaction with its directors or managers (the so-called 'contract with one-self') or when a director or manager simultaneously acts as the representative of the company and as the representative of the contracting party (the so-called 'dual representation'). Both situations entail a risk of conflict of interest.

The Swiss Supreme Court has long held that self-dealing transactions are inadmissible and therefore null and void, unless (a) their very nature is such that any risk of harm to the company can be ruled out (e.g., if they are entered into at arm's length) or (b) they have been subject to a prior authorization or a later approval by a non-conflicting corporate body of the same rank or higher. These two alternative material requirements for the admissibility of self-dealing transactions call for clarifications, which this bulletin aims to provide (*infra* IV.) after a brief presentation of facts (*infra* II.) and a summary of a recent decision of the Swiss Supreme Court (*infra* III.).

II. FACTS

A tenant company entered into a lease agreement with a landlord company. The landlord's director was also one of the tenant's two managing directors. A few months later, the tenant requested that the first rent payment be deferred. The landlord agreed to this request through its director (who was also the tenant's director). The landlord subsequently revoked the mandate of its director for cause. Notwithstanding the agreement between the parties to defer the payment of rent, the landlord put the tenant on notice to pay certain rents. When the tenant failed to pay, the landlord terminated the lease.

III. DECISION

The Swiss Supreme Court had to rule on the validity of the landlord's notice of termination, which led it to assess whether the agreement between the parties to defer payment of the rent was valid. The Court first held that the agreement reached by the parties to defer payment of the rent was made in the context of dual representationThe Swiss Supreme Court went on to point out that there were no exceptions that would make dual representation valid in this case. In fact, the contract did not correspond to market conditions insofar as the payment deadline was excessively generous for the tenant, depriving the landlord of rent for an indefinite period.

IV. ANALYSIS: SELF-DEALING TRANSACTIONS

Self-dealing (*opération pour propre compte; Insichgeschäft*) refers to two situations: (i) dual representation (*double representation; Doppelvertretung*), where the same representative acts for both parties to the contract, and (ii) contract with oneself (*contrat avec soi-même; Selbstkontrahierung*), where the same

person is a party to the legal act in two different capacities, namely on the one hand on its own behalf and on the other hand as the representative of another person. Both situations entail a risk of conflict of interest, between the interests of the two persons represented by the same representative in the first case and between the interests of the principal and those of the representative (who is also a party to the contract) in the second case.

The issue of self-dealing transactions commonly arises in cases of legal representation of a legal entity by its corporate bodies, in particular when a company enters into a transaction with its director or manager (contract with one-self) or when a director or manager simultaneously acts as the representative of the company and as the representative of the contracting party (dual representation). Directors and managers have a duty of loyalty, which imposes upon them an obligation to both avoid and manage conflicts of interests[1]. In both of these cases, there is a risk that they compromise the objectivity required to perform their duties by either favoring their own interests or showing partiality in assessing the interests of one party (*i.e.*, their own interests) to the detriment of the other (*i.e.*, the interests of the company). As a result, the presumption that both parties pursue their own interests does not hold.

Statutory law explicitly imposes only one formal requirement for accepting self-dealing: if the company is represented in the conclusion of a contract by the person with whom it is concluding it, such contract must be done in writing, unless it is entered into in the ordinary course of business and the value of the company's goods or services does not exceed CHF 1,000[2].

As to the Swiss Supreme Court, it has long held that self-dealing transaction are inadmissible and therefore null and void. In fact, it considers that the presumed intention of the company is to exclude the powers of representation of its corporate bodies for any act involving a risk of conflict between its own interests and those of its representative. It notes, however, that if the corporate body entering into a self-dealing transaction is also the sole shareholder of the company, the latter does not need to be protected because the transaction necessarily corresponds to the intention of the company and is therefore covered by the power of representation of that corporate body.

The decision of the Swiss Supreme Court under review confirms that there are two exceptions to the inadmissibility of self-dealing transactions, namely: (i) if the principal has consented in advance or has ratified the transaction or (ii) if the very nature of the transaction precludes any risk of harm to the principal.

First, self-dealing transactions are admissible if their nature is such that any risk of harm to the company can be ruled out. The Swiss Supreme Court confirms that this is the case where the transaction is made 'at arm's length'. To overturn the presumption of the existence of conflicts of interest, the self-dealing transaction must be concluded on the same commercial terms as if the contracting parties were unrelated. In particular, the ratio between the performance and the counter-performance must be adequate. The adequacy of the consideration offered for goods or services in comparison to market prices or exchange quotations or the confirmation thereof by a neutral third-party expert in a 'fairness opinion' may serve as an indication that the arm's length principle is complied with, but other relevant circumstances must also be taken into account (e.g., the significance of the security interest compared to the other assets of the company and the financial capacity of the company). However, in addition to being concluded at arm's length, the self-dealing transaction must make economic sense for the company, be necessary or in its best interest, be appropriate in terms of timing and be adequate and proportional; otherwise (e.g., if a corporate body purchases at market price an excessive quantity of goods compared to the company's needs), a prior authorization or a later approval by a corporate body of the same rank or higher (see below) is necessary for such transaction to be admissible.

Second, self-dealing transactions are admissible if they have been subject to a prior authorization or a later approval by a corporate body of the same rank or higher, *i.e.* by the members of the board of directors unaffected by the conflict of interest or by the general meeting of shareholders (which should be given sufficient information to enable them to make an informed decision). If the company has only one non-conflicted director and he/she has a collective signing authority, some legal scholars consider that he/she cannot approve such transaction, in which case approval should be granted by the general meeting of shareholders.

It follows that the first exception to the inadmissibility of self-dealing transactions, that is if their very nature is such that any risk of harm to the company can be ruled out, leads to legal uncertainty. Therefore, from a practical standpoint, companies are well-advised to rely on the approval of such transactions by non-conflicting members of the board of directors or, in the absence of such, by the general meeting of shareholders.

1 Art. 717 of the Swiss Code of Obligations (CO).

2 Art. 718b CO.

Last but not least, there is no requirement for a self-dealing transaction to be adequate if it is duly approved by the company. Therefore, arises the question of the protection of creditors. The Swiss Supreme Court considers that the purpose of the prohibition on entering into self-dealing transactions is to protect the interests of the company. The interests of creditors should not be taken into account in this context, as they have other legal remedies at their disposal. In particular, they can introduce a revocatory action (*action révocatoire*)[3] or file a liability claim against the members of the board of directors of the company based on Art. 754 CO, which provides that the latter are liable to the creditors for any losses or damage arising from any intentional or negligent breach of their duties[4]. The Swiss Supreme Court also points out that the interests of creditors are protected by the rules prohibiting the returns of capital to shareholders[5] and hidden distributions of profits[6], which render the transaction in question null and void.

The company must nonetheless comply with the statutory rules on imminent insolvency[7], loss of capital[8] and overindebtedness[9]. Accordingly, we are of the opinion that neither the non-conflicted members of the board nor the general meeting should grant their approval to a self-dealing transaction if it puts the company in a situation of imminent insolvency (*i.e.*, the company is threatened with insolvency), loss of capital (*i.e.*, the company's assets less its liabilities no longer cover half of the sum of its share capital) or overindebtedness (*i.e.*, the company's liabilities are no longer covered by its assets). Otherwise, the members of the board having approved such transaction would be exposed to a liability claim from the company's shareholders and/or creditors based on the aforementioned Art. 754 CO, whereas the shareholders would face the consequences of the aforementioned rules, which ultimately may lead to the declaration of bankruptcy.

3 Art. 285 et seq. of the Swiss Federal Act on Debt Enforcement and Bankruptcy (DEBA).
4 Art. 754 para. 1 CO.
5 Art. 680 para. 2 CO.
6 Art. 678 CO.
7 Art. 725 CO.
8 Art. 725a CO.
9 Art. 725b CO.

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