

# Update

## Newsflash September 2019

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### New leading case regarding transfer restrictions for registered shares

**In a recent new leading case (4A\_623/2018 dated July 31, 2019), the Swiss Federal Supreme Court addressed a number of questions regarding the transfer restrictions for unlisted registered shares. On the one hand, the Supreme Court confirmed the standing of the buyer of the shares to bring an action against the rejection of the transfer of the shares by the company. On the other hand, the Court held that the so-called "Business Judgment Rule" is not applicable for the review of the decision of the board of directors to reject the transfer of shares. However, in reviewing the board's decision to invoke the "Escape Clause" the Supreme Court also exercises restraint. Finally, the Supreme Court rejected the extension of the majority shareholder's contractual share transfer duty to a company by such shareholder.**

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#### Facts

In summary, the Federal Supreme Court had to assess the following facts:

A. Ltd. (defendant) is the owner and operator of a hotel in the city of Chur. Its majority shareholder, C. Ltd., is controlled by the sole shareholder F. In case of a sale of A. Ltd. or the hotel operated by A. Ltd., F. had granted his sister B. (plaintiff) a pre-emption right. Subsequently, C. Ltd. attempted to sell its majority stake in A. Ltd., consisting of registered shares with restricted transferability, to its managing director H. Thereupon, B. enforced her pre-emption right and C. Ltd. (controlled by F.) was ordered in a final and binding court decision to transfer its shares in A. Ltd. to B. However, the board of directors of A. Ltd. (which included F.) refused to approve the transfer of the shares.

Instead, A. Ltd. made an offer to plaintiff B. to acquire the shares for the account of the managing director H. B. brought an action against A. Ltd. and requested an order to A. Ltd. to approve the share transfer and to list her as shareholder in the shareholders' register. The Regional Court of Plessur upheld the action. An appeal to the Cantonal Court of Graubünden was rejected. The Federal Supreme Court, however, upheld the appeal by A. Ltd. against this decision and rejected the action of B.

#### Principles of the transfer restriction for registered shares

According to Art. 685a para. 1 CO, the articles of incorporation of a Swiss corporation may provide that registered shares may only be transferred with the consent of the company (share transfer restriction). In case of unlisted

registered shares, which were the subject of the present case, Art. 685b para. 1 CO provides that the company may, in principle, only reject the transfer of shares if it asserts an important reason as defined in its articles of incorporation. Alternatively, the company may offer the seller to take over the shares at actual value for its own account or for the account of a shareholder or a third party ("Escape Clause").

The application of the share transfer restriction by a company or its board of directors, respectively, is subject to judicial review. The action to enforce the transfer of registered shares must be brought against the company and aims at specific performance, i.e. a court order to the company to approve the share transfer and to list the buyer of the shares as new shareholder in the shareholders' register.

### **The buyer of the shares may challenge the rejection of the share transfer as well**

The action reviewed by the Federal Supreme Court was brought by the buyer of the shares B. Thus, the Supreme Court had first to determine whether the buyer of registered shares with restricted transferability was entitled to challenge the rejection of the share transfer. So far, this question has been disputed in legal doctrine and was left unanswered or at least not explicitly addressed by the Supreme Court. In the present leading case, the Supreme Court held that the buyer of the shares was in principle not entitled to bring an action against the company as the buyer is not (yet) a shareholder at that point. However, the share transfer restriction or the Escape Clause, respectively, interfere with the share purchase agreement between the seller and the buyer. Therefore, according to the Supreme Court, the buyer of the shares must have standing to bring an action against the rejection of the share transfer as well. The admission of such standing is, thus, primarily justified by reasons of expedience.

### **Even though the "Business Judgment Rule" does not apply to the restriction decision, it is only reviewed with judicial restraint**

Furthermore, it was disputed before the Supreme Court whether the so-called "Business Judgment Rule" should be applied to the review of the

board's decision to reject the transfer of shares. According to the "Business Judgment Rule", a court may review a business decision based on a flawless decision-making process (which must itself be based on adequate information and be free of conflicts of interests) with restraint. The lower instance court had assumed that the "Business Judgment Rule", in principle, also applied to the review of the board's decision to reject the transfer of shares. In the present case, however, the lower court had not applied the "Business Judgment Rule" since it deemed the prerequisites for this rule not fulfilled and hence proceeded with a comprehensive assessment of the board's decision (and as a result, expanded the scope of this review as to whether the board had properly exercised its discretion).

The Supreme Court held that its decisions regarding the "Business Judgment Rule" concerned cases of director and officer liability according to stock corporation law (Art. 754 CO) and applied to the evaluation of business decisions. The "Business Judgment Rule" prevents courts from assuming that in hindsight it could better judge a business decision than the responsible person at the time and in the context of a specific situation. In contrast, other responsibilities of the board of directors, namely control and organizational duties are better suited for judicial review after the fact. According to the Supreme Court, this applies also to the decision of the board of directors to reject the transfer of shares by invoking the "Escape Clause". Therefore, this decision does not fall within the scope of the "Business Judgment Rule".

According to the Supreme Court, the following applies to the review of the board's decision to reject the transfer of shares and to offer to the seller to take over the shares at actual value ("Escape Clause"): In contrast to a rejection without offering a takeover, such decision neither requires an important reason nor the giving of any reason. However, such decision must respect the principle of equal treatment of all shareholders and the prohibition to act arbitrarily. The latter is violated in particular in case the decision cannot be justified by reasonable business considerations. In order to determine whether a decision was justified by reasonable business considerations, the interests of both the company and the entirety of the

shareholders must be taken into account. However, the Supreme Court does not assess whether the decision is adequate.

In the present case, the board of directors had rejected the transfer of shares and had offered to take over the shares for the account of the successful managing director of the company because said managing director would leave the company in case the buyer of the shares acquired the majority of the share capital. Contrary to the court of lower instance, which reviewed the board's exercise of its discretion regarding this question, the Supreme Court concluded that avoiding the threatened departure of the managing director is a legitimate reason in the interest of the company and that the decision of the board was, therefore, not abusive.

### **Rejection of a (reverse) piercing of the corporate veil in case of a company that is not wholly owned by one shareholder**

Finally, the Supreme Court addressed the alternative reasoning of the court of lower instance, according to which the duty of the majority shareholder C. Ltd. to transfer the shares to the plaintiff B. extended to its subsidiary A. Ltd and C. Ltd. should not be able to hide behind the decision of the board of directors of A. Ltd. to reject the share transfer.

First, the Supreme Court cited its (specific) case law regarding the piercing of the corporate veil. In the case at hand, it rejected a (reverse) piercing of the corporate veil from the majority shareholder to the company to enforce the shareholder's obligation to transfer the shares. The Supreme Court reasoned that contractual obligations are only binding for the parties to the contract and that an extension of a contractual obligation of the majority shareholder to the company controlled by such shareholder would circumvent the share transfer restriction as a fundamental legal concept of corporate law. The corporate and the contractual sphere must be strictly separated. Furthermore, the Federal Supreme Court held the fact that a company is majority-owned by one shareholder is generally

not sufficient for a (reverse) piercing of the corporate veil. In such case, the interests of the minority shareholders who are not related to the majority shareholder must be protected. The protection of these interests excludes that personal liabilities of the majority shareholders may be imposed on the company. Therefore, the alternative reasoning of the court of lower instance violated Swiss federal law as well. As a result, the Supreme Court upheld the appeal of the defendant.

### **Implications for future share transfer restriction cases**

The clarification by the Supreme Court that not only the seller of registered shares but also the buyer has standing to bring an action against the rejection of the share transfer is helpful.

The invoking of the "Escape Clause" permits the board to reject the transfer of shares without giving any reasons (contrary to a rejection that is based on important reasons). When reviewing this decision, the Supreme Court exercises restraint and limits its review to the question as to whether such decision respects the principle of equal treatment of shareholders and is justifiable. In the end, this may result in a similar outcome as the application of the "Business Judgment Rule". However, this rule is not applicable to such decision as this is not about reviewing a business decision but only as to whether the prerequisites of a legal provision, here the "Escape Clause", are met.

However, the new leading case of the Supreme Court does not address the question as to whether the "Business Judgment Rule" applies to cases in which liability claims are brought against board members in connection with their decision to reject the transfer of registered share. At least with respect to the liability for the costs of the litigation over such rejection, the Supreme Court held in an earlier leading case (BGE 139 III 24) that the "Business Judgment Rule" applies in principle.

**Please do not hesitate to contact us in case of any questions.**

**Legal Note:** The information contained in this UPDATE Newsflash is of general nature and does not constitute legal advice. In case of particular queries, please contact us for specific advice.

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