

Update

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State liability: no compensation for indirect damage of shareholders

In a recently published decision (2C_809/2018), the Swiss Federal Supreme Court rejected damages claims brought by former shareholders of TEMPUS Privatbank Ltd based on the Swiss Federal Liability Act. The shareholders – among them former majority shareholder Oskar Holenweger, who held approx. 90% of the shares – argued that they had been forced to make an emergency sale of the bank following unlawful acts by various Swiss authorities, and that they suffered damage due to the depreciation of their shares. According to the Swiss Federal Supreme Court, such indirect damage is not compensable.

Facts

In June 2003, the Swiss Federal Criminal Police ("BKP") informed the Swiss Federal Banking Commission ("EBK", today Swiss Financial Market Supervisory Authority FINMA) that Oskar Holenweger – the former Chairman of the Board and managing director of TEMPUS Privatbank Ltd (the "Bank") – was offering to launder money that stemmed from organized crime and drug trafficking, respectively. BKP had obtained this information from a convicted narcotics trafficker. In December 2003, EBK issued a preliminary injunction, by which, among other things, KPMG was appointed as an observer of the Bank. Simultaneously, Mr Holenweger was remanded in custody by the criminal prosecution authorities for almost two months.

KPMG's reporting held that the Bank's financial situation was strained and that its operating activities could only continue for a short time

period. KPMG's reports also stated that a rapid improvement of the Bank's equity base through a strategic partner or a buyer was inevitable.

Following the criminal investigation as well as the supervisory proceedings, an emergency sale of the Bank took place on 2 February 2004.

After several years of investigation, in May 2010, the Office of the Attorney General of Switzerland ("OAG") brought charges against Mr Holenweger for forgery of documents, criminal mismanagement, (attempted) aggravated money laundering and bribery of foreign public officials. The Swiss Federal Criminal Court eventually dismissed the case against Mr Holenweger with respect to one count and acquitted him from all other charges. Specifically, the Swiss Federal Criminal Court found that the OAG's suspicions, which led to the initiation of the investigation, were "meagre" and that the allegation that Mr Holenweger laundered money

for the drug cartels was not even remotely substantiated.

Based on the final judgement of the Swiss Federal Criminal Court, in April 2012, Mr Holenweger and a former co-shareholder of the Bank lodged a claim for compensation against the Swiss Confederation based on the Swiss Federal Liability Act ("VG"). The former shareholders of the Bank argued that they had been forced by the illegal conduct of the OAG, the BKP, the EBK and KPMG as deployed observer, to execute an emergency sale of the Bank, thereby realizing a price that was below market value, and, consequently, suffered damage.

By decision of 18 June 2019, the second public law division of the Swiss Federal Supreme Court finally dismissed these damages claims.

In principle, the loss in value of the shares caused by the forced emergency sale, qualifies as damage within the meaning of the law

In its decision, the Supreme Court first states that, pursuant to Article 3 VG, damages may only be awarded if the authorities acted wrongfully, i.e., either (i) by violating an absolute right of the aggrieved party (property, personality, *Erfolgsunrecht*), or (ii) by causing pecuniary losses through the breach of a protective rule (wrongful conduct, *Verhaltensunrecht*). The Swiss Federal Supreme Court reiterates that in line with its constant practice, damage may consist of an involuntary reduction of assets, an increase of liabilities or lost profits.

In the present case, the Supreme Court distinguished between three different constellations of damage:

- (1) The damage suffered by Mr Holenweger personally as accused person in the context of the criminal proceedings. These damages claims had already been dealt with by the Swiss Federal Criminal Court pursuant to Article 429 of the Swiss Criminal Procedure Code, and were, therefore, not at issue in the proceedings before the Swiss Federal Supreme Court.

- (2) The damage suffered by the Bank due to the incarceration and prosecution of Mr Holenweger, as well as due to the actions of the EBK and KPMG. These damages claims were not part of the dispute either, as the Bank (which had been sold and ceased to exist following a merger) did not appear as an aggrieved party.
- (3) The damage suffered by the (former) shareholders of the Bank as a result of the depreciation of their shares. These damages claims were the only subject of the proceedings before the Supreme Court. The former shareholders quantified this damage as the difference between the real value of the shares before the intervention of the EBK and the price achieved in the context of the emergency sale.

For this last constellation, the Supreme Court held that the sale of the Bank's shares following pressure from the criminal prosecution led to a realization of a loss in value of the shares, which was unwanted and, thus, qualifies as damage pursuant to the Supreme Court's practice. However, that does not automatically mean that the Swiss Confederation is liable to compensate this damage.

Pursuant to general principles of Swiss tort law, only "direct damage" must be indemnified

Pursuant to general principles of Swiss tort law, only direct damage must be indemnified. In other words, only the person that is directly affected by unlawful conduct and who has suffered direct damage to his or her assets may claim compensation.

Based on its jurisprudence in the context of officer and director liability – where the distinction between direct and indirect damage depends on whether the damage occurred in the company's or in the shareholder's assets – the Supreme Court concludes also for tort law in general that the decrease in the value of shares qualifies as direct damage of the company. On the other hand, the losses suffered by the shareholders in their capacity as equity holders of the directly aggrieved company is merely an indirect damage. In principle, such indirect damage must not be indemnified. Consequently, the Supreme Court ruled that the damages

claimed by the former shareholders of the Bank, which had arisen due to the forced emergency sale of their shares, must not be indemnified.

Unsatisfactory result and relevance for future cases

In the particular case at hand, the Supreme Court's ruling has the (rather irritating) consequence that the majority shareholder of the Bank, who was forced to sell his shares in an emergency sale due to unlawful criminal proceedings and parallel supervisory measures, cannot claim compensation for the resulting value depreciation of his shares. Although the decision is legally comprehensible, the result is unsatisfactory.

The decision suggests that, in principle, the Bank itself could have successfully asserted the "direct"

damage it had suffered because of the unlawful actions by the Swiss authorities. Consequently, it is advisable for similar future cases of emergency sales to clearly define as part of the share purchase agreement the rights and obligations of the parties and the company in question, respectively, with regard to the assertion of damages claims. One possible solution would be that the company assigns its state liability damages claims to the selling shareholders. However, apart from the fact that in the context of an emergency sale the selling shareholders will hardly have any bargaining power, this proposed approach raises a number of corporate and tax law issues.

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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