Shareholders' dispute regarding a former joint venture: Are today's partners tomorrow's enemies?

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The interpretation of a shareholders' agreement in a former joint venture which provided for option rights upon change of control.

Judgment of the Federal Supreme Court of 21 February 2020
Case Reference : 4A_357/2019

Facts

The dispute between a Swiss banking software and outsourcing provider (the "Software Provider") and a Swiss bank (the "Bank", which had acquired the majority of the assets and liabilities of a third party company [the "Company"], including the matter of the dispute), amounting to CHF 90 million plus interest, arose out of a former joint venture. The Company had outsourced its IT division since the late 1990s and had established a subsidiary (the "Subsidiary") to develop its own software platform. This IT solution was later abandoned. By the end of 2007, the Subsidiary had acquired a software banking license from the Software Provider in which the latter made its know-how available to the former. The condition for this supporting role was that the Software Provider would acquire a majority shareholding in the Subsidiary. Furthermore, the service relationship between the Company and the Subsidiary was to be clearly governed by a contract. The Software Provider had acquired a 51% stake in the Subsidiary from the Company for CHF 32.5 million plus an earn-out payment until the end of 2015 totaling CHF 39.4 million. The service relationship between the Company and the Subsidiary was established through an Agreement on Outsourcing Services dated August 25, 2011 (the "Service Agreement"). The Software Provider and the Company also entered into a shareholders' agreement dated August 29, 2011 (the "Shareholders' Agreement"). The Shareholders' Agreement provided for option rights regarding the Company's remaining 49%-stake in the Subsidiary when contractually defined trigger-events had been met. The Software Provider had a call option and the Company had a put option.

On July 14, 2014, the Company's former owner agreed to sell the Company to a Brazilian company. The transaction was completed on September 15, 2015. This change of control constituted a trigger-event within the meaning of the Shareholders' Agreement. The Software Provider decided to exercise its call option to acquire the Company's remaining 49%-stake in the Subsidiary. As the parties were unable to agree on the purchase price of the shares, they initiated an arbitration-based price-fixing process provided for in the Shareholders' Agreement. Eventually, they agreed on the amount of CHF 90 million as consideration for the shares on January 29, 2016 outside the arbitration proceedings (the "Price Agreement"). The Software Provider paid this amount on February 5, 2016. On February 22, 2016, the Brazilian company further sold the Company to the Bank. As the Bank decided to integrate the Company into its own banking system going forward, the Company terminated the Service Agreement with the Subsidiary on March 11, 2016 as of December 31, 2017 (i.e., less than one and a half months after entering into the Price Agreement).

After termination of the Service Agreement, the Software Provider considered itself to be entitled to claim back the entire purchase price (i.e., CHF 90 million) pursuant to a so-called price reduction under the Service Agreement (the "Price Reduction"), based on the terms of the Shareholders' Agreement. The Price Reduction was defined by the Shareholders' Agreement as the sum equal to the difference between the option price before termination of the Service Agreement and the hypothetical price after termination of the Service Agreement. The Software Provider claimed that due to the termination of the Service Agreement, it had lost its biggest customer and had suffered a massive loss in value. It filed a lawsuit at the Commercial Court of the Canton of Zurich and requested that the Bank be ordered to pay it CHF 90 million plus interest at 5% since February 5, 2016. The plaintiff asserted that the Price Reduction was due upon exercise of the call option and not merely upon exercise of the put option.

The Commercial Court of the Canton of Zurich dismissed the plaintiff's claim in its entirety on various grounds, namely: the subsequent conduct of the plaintiff proved, when entering into the Shareholders' Agreement and in agreement with the Company, that no Price Reduction was owed upon exercise of the call option. In particular, the Court highlighted the behavior of the parties during the arbitration proceedings and negotiations, which resulted in the Price Agreement. Accordingly, it confirmed the existence of a real common contractual intent of the parties (i.e., the existence of a so-called "natural consensus" between the parties, in German: "*tatsächlicher Konsens*"; in French: "*accord de fait*") as alleged by the defendant.

In its judgment of February 21, 2020, the Federal Supreme Court dismissed the plaintiff's appeal without considering the merits of the case.

Issue

The Federal Supreme Court had to determine whether the Commercial Court's findings of fact, according to which the parties to the Shareholders' Agreement had a real common contractual intent regarding the scope of application of the Price Reduction as being limited to the defendant exercising the put option, were tainted by arbitrariness pursuant to Art. 9 of the Federal Constitution.

Judgment

Given that the issue at hand is a matter of contract interpretation, the Federal Supreme Court first underscored the fundamental principle under Swiss law that interpretation of contractual provisions is subject to ascertaining the true and common intention of the parties (Art. 18 para. 1 of the Swiss Code of Obligations). In order to determine the intention of the parties, a court has to take into account all circumstantial evidence, which includes not only the specific circumstances surrounding the conclusion of the contract but also the conduct of the parties after the conclusion of the contract.

If the court fails to determine the true and common intention of the parties or concludes that there is no consensus between the parties, the contract has to be interpreted pursuant to objective interpretation, which consists in analyzing the parties' declarations and behaviors in light of the good faith principle. In other words, the subjective method of contract interpretation prevails over the objective method of contract interpretation. The distinction serves as a boundary to define the Federal Supreme Court's power of judicial review. While objective interpretation is a matter of law, subjective interpretation is a matter of fact, to which the Federal Supreme Court is bound as a matter of principle (Art. 105 para. 1 of the Federal Supreme Court Act [FSCA]). Findings of fact such as the true and common intention of the parties may only be reviewed by the Federal Supreme Court with very limited judicial scrutiny, the standard of review being arbitrariness under Art. 9 of the Federal Constitution (cf. Art. 97 para. 1 FSCA and Art. 105 para. 2 FSCA). A court is deemed to have decided in an arbitrary manner when it disregards evidence that is likely to affect the decision without sound judgment, when it manifestly misinterprets its meaning and scope, or when it reaches untenable findings on the basis of evidence on the record.

The Federal Supreme Court reiterated that a judgment may be found to be arbitrary if both its reasoning and outcome are arbitrary. In addition, the reasons for arbitrariness must be precisely substantiated (cf. Art. 106 para. 2 FSCA). An appeal that does not meet these requirements will be dismissed without the Federal Supreme Court considering the merits of the case. Moreover, the statements must be made in the appeal itself; a mere reference to statements in other legal documents or to the files is not sufficient. Finally, the appellant may not use its right of reply to substantiate or strengthen an appeal. In the reply, only arguments which were first raised by the comments in the submission of another party to the proceedings are admissible.

The Federal Supreme Court then turned to the Commercial Court's findings of fact and its conclusion that the parties had expressed their real common contractual intent regarding the scope of application of the Price Reduction subsequent to the conclusion of the Shareholders' Agreement that shall apply exclusively in case of the Company exercising the put option. According to the Commercial Court, the arbitrator appointed as part of the arbitration proceedings had expressly requested the Software Provider and the Company to comment on a provision of the Shareholders' Agreement regarding the Price Reduction. It was further established in this regard that the Company had specifically recognized that no Price Reduction was due if the call option had been exercised, a statement which was not refuted by the Software Provider. During the arbitration proceedings, the Software Provider had not argued that the Price Reduction regarding the call option was to be determined at a later stage if the Service Agreement was subsequently terminated.

Assuming that the Software Provider, when concluding the Price Agreement in January 2016, had interpreted the

Shareholders' Agreement as providing for a Price Reduction in case of exercise of the call option and of subsequent termination of the Service Agreement by the Company (which, as a practical matter in light of the Company's right to terminate the Service Agreement by mid-March 2016, was likely to happen given the on-going takeover negotiations regarding the Company), the Software Provider would have been in a position to receive the CHF 90 million it paid as part of the 49%-stake in the Subsidiary while keeping the shares. This position, however, was inconsistent with the Company's statement in the arbitration proceedings that no Price Reduction was owed upon exercise of the call option or even afterwards. Furthermore, the Commercial Court found that the Software Provider's argument that it had already contested a natural consensus between the parties had no merit. More specifically, as stated by the Commercial Court, the contractual provisions referred to by the Software Provider in both the Price Agreement and the Shareholders' Agreement to contend that no real common contractual intent was expressed by the parties did not provide for the right to a Price Reduction in case of exercise of the call option. It was, therefore, not established that the Software Provider was contractually entitled to a Price Reduction in case of exercise of the call option, or that it could rely on a corresponding subjective intent of the parties supporting this position.

The Federal Supreme Court subsequently examined whether the Commercial Court's conclusion that the parties had mutually agreed on the scope of application of the Price Reduction to be limited to the exercise of the put option was arbitrary under the facts of the case. It emphasized that the Software Provider's main argument, which relied on its interpretation of the Shareholders' Agreement upon conclusion of the Price Agreement as providing for a Price Reduction in the instance where the call option was exercised, had already been addressed – and dismissed – by the Commercial Court. The Software Provider had not disproved the Commercial Court's finding that there was sufficient evidence stemming from the conduct of the parties after their entering into the Shareholders' Agreement, namely during the arbitration proceedings, to conclude that the Software Provider and the Company had mutually agreed on the scope of application of the Price Reduction to be limited to the exercise of the put option. In any case, the Federal Supreme Court found that the Software Provider had not demonstrated in a legally adequate manner that the Commercial Court's reasoning as to the parties' real common contractual intent and outcome was arbitrary. In addition, it pointed out that the Software Provider's statement in its reply that the Price Reduction shall not be calculated ex ante and hypothetically upon exercise of the call option, but ex post and specifically upon termination of the Service Agreement, was not admissible for two reasons: 1) this argument was belated, because it was raised only in the reply; and 2) it could not call into question the merits of the Commercial Court's conclusion as to the existence of the real common contractual intent of the parties.

As a result, the Federal Supreme Court ruled that the Commercial Court's conclusion that the Software Provider and the Company had expressed their real common contractual intent regarding the (limited) scope of application of the Price Reduction under the Shareholders' Agreement was not arbitrary. It therefore dismissed the Software Provider's appeal without considering the merits of the case.

Key takeaway

At least two key takeaways arise from this judgment of the Federal Supreme Court.

The first one – which relates to substantive law – is a reminder that the subjective method of contract interpretation under Swiss law supposes that a court shall go beyond the text in order to assess the existence of a real common intention of the parties. In order to determine the real and common intention of the parties, the court not only takes into account all the circumstances that lead to the conclusion of the contract (i.e., negotiations, correspondence, or any other expression of intent), but also those that occur after the conclusion of the contract, such as the parties' subsequent conduct. The parties' subsequent conduct is relevant to the subjective interpretation if it provides convincing evidence of the will of the parties upon conclusion of the contract. Subjective interpretation is a point of fact that, as a matter of principle, cannot be reviewed by the Federal Supreme Court when hearing an appeal on questions of law.

The second one – which relates to procedural law – is that pleas in law and arguments put forward in an appeal must be provided in the appeal itself and not in a subsequent submission (in this case in the reply). In the reply, new pleas in law and arguments are inadmissible unless they refer to and address statements contained in the submission of another party to the proceedings.

Comment

This case illustrates (once again) the importance of careful contract drafting in complex business transactions. It also confirms that the distinction between the subjective method and objective method of contract interpretation (this last method applies only if the subjective method cannot apply and consists in analyzing the parties' declarations and behaviors

in light of the good faith principle [cf. Art. 2 para. 2 of the Swiss Civil Code]), may be difficult to apply in practice. The application of the good faith principle refers to the content of the parties' declarations and the circumstances (facts). This distinction is nonetheless imposed by the Federal Supreme Court because it arises from the distinction between facts and law and demonstrates the power of judicial scrutiny. This case is also interesting because it constitutes one of the few cases where the court is in a position to determine the real common intent of the parties (based on the subjective method of contract interpretation). In most cases, the courts cannot establish the facts that prove the real common intent of the parties and as a result must apply the objective method of contract interpretation by default.

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