How long shall the seller be liable?

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Liability of the seller for third party litigation in a Share Purchase Agreement: is the time limit applicable only to the bank guarantee or also to the indemnification obligation of the seller?

Judgment of the Federal Supreme Court of 30 July 2020

Case reference : 4A_186/2020

Facts

The dispute concerned a share purchase agreement (the "SPA") between Z (the "Seller") and X. SA (the "Purchaser") for shares of the company W. SA (the "Target Company"). At the time of the conclusion of the SPA on December 3, 2007, both parties were aware that the Target Company had an ongoing conflict with a former agent of the Target Company (the "Agent") who had initiated court proceedings in which he claimed the payment of CHF 738,500 from W. SA. The risk of said dispute was reflected in Article 6 of the SPA as follows:

"In view of the potential procedural risk of the claim raised against [the Target Company] by [the Agent], the [S]eller shall undertake to secure this risk to the [P]urchaser by issuing of a first-rate bank guarantee of CHF 850,000, which shall be maintained until a final and enforceable judgment is rendered on the matter, but which shall be fully released by February 28, 2012 at the latest in any event and without any further condition.
In the event that [the Target Company] should lose in these proceedings, the said guarantee shall be released subject to the amount charged to W. SA".[1]

In execution of the SPA, the Purchaser paid the last installment of the sales price on July 30, 2008. The Parties signed a SPA closing protocol on the same day, by which they confirmed the obligation of the Seller to issue a bank guarantee. Upon instruction of the Seller, a bank issued a bank guarantee on the same day that was valid until February 28, 2012 (pursuant to Art. 6 of the SPA). The bank guarantee was released on that date.

The court proceedings initiated by the former Agent against the Target Company ended only on March 17, 2016 (i.e. over four years after the release of the bank guarantee). The Target Company was ordered to pay CHF 363,000 plus 5% interest as of September 30, 2001 and expenses amounting to CHF 39,000. On February 17, 2017, the Purchaser sued the Seller before the Court of First Instance claiming the payment of approximately CHF 880,000 on the grounds that the Seller had the contractual obligation to reimburse the costs of litigation with the Agent. The Court of First Instance rejected the Purchaser's claim, which was later upheld by the Court of Appeal.

Issue

The Federal Supreme Court had to decide on the interpretation of Art. 6 of the SPA. In other words, it had to assess whether the Seller was no longer liable through the application of this contractual provision (which was the verdict reached by the Cantonal Courts). More specifically, the issue was whether Art. 6 of the SPA set a time limit for the liability of the Seller whereby the liability would expire when the bank guarantee was to be released (i.e. February 28, 2012).

Decision

The Federal Supreme Court was confronted with two vastly diverging interpretations of Art. 6 of the SPA. The Purchaser claimed that the Seller was obliged to reimburse him for any costs incurred in the proceedings against the former Agent without limit in time, and without being bound by the time limit for the release of the bank guarantee, which had to be released at the latest on February 28, 2012. The Purchaser claimed in this respect that the bank guarantee to be provided

by the Seller was only intended to confirm the Seller's ability to perform its obligation to reimburse the Purchaser until February 28, 2012. The Seller, on the other hand, claimed that Art. 6 of the SPA had to be interpreted as meaning that its sole obligation was to provide a bank guarantee until February 28, 2012, with no further obligation following the expiration date of the bank guarantee.

In its decision (reference ACJC/292/2020), the Court of Appeal (similarly to the Court of First Instance) came to the conclusion that the contract, in particular Art. 6 of the SPA, expressed the real and common intention of the parties pursuant to Art. 18 of the Swiss Code of Obligations ("SCO"). It reached this decision by taking into account the documents that the Parties had used during the negotiations that led to the SPA: the annexes to the SPA, a clause in the agreement stating that the SPA shall replace all previous written or oral agreements between the Parties, other sections of the SPA, the SPA closing protocol, as well as the expectations of the parties with regard to the likely outcome of the proceedings between the Target Company and the Agent.

In its decision, the Federal Supreme Court summarily confirmed the Court of Appeal's judgment that Art. 6 of the SPA expressed the real and common intention of the parties (based on subjective contract interpretation which looks at facts) and that Art. 6 only required the Seller to provide a bank guarantee that was limited in time. The Federal Supreme Court further stated that the Purchaser had not pleaded that the Court of Appeal had applied the wrong method of interpretation and had simply used the appeal to reiterate its arguments from the proceedings before the Court of Appeal.

Key takeaway

This case constitutes an important reminder of the precision required when formulating guarantee provisions in share purchase agreements. In particular, parties (and their counsel) are strongly advised to clearly set out what shall be the term of the liability of the seller for any third-party litigation risks. In this case, the liability of the Seller was set out in such a way that it was interpreted to consist only in the issuance of a bank guarantee that was limited in time and to be released at the latest by a certain date, which was well before the litigation, whose risk was at the heart of the issue, had terminated.

The case further illustrates that whenever a lower court reaches the conclusion that a contract corresponds to the parties' true and corresponding intent on the grounds of subjective interpretation, it is a question of fact and thus not a question of law. This means that the review by the Federal Supreme Court is extremely limited and that a reversal of a lower court judgment is highly unlikely.

Comments

Swiss contract law distinguishes between subjective and objective contract interpretation. According to this principle derived from Art. 18 SCO, a contract has to be interpreted primarily subjectively. This means that courts are held to give the contract the meaning that corresponds to the common inner will of the parties at the time the contract was concluded. Only where such common intent cannot be established, should Courts resort to interpret the contract objectively, i.e. determine how a reasonable party in the position of the parties to the contract could have understood the agreement. It is clearly established by the Federal Supreme Court's caselaw that the question of whether or not the parties had a common inner will at the time the contract was concluded, is a question of fact that cannot be reviewed by the Federal Supreme Court except in cases of manifest error. In other words, the Federal Supreme Court can only review decisions where the Cantonal Courts have resorted to objective interpretation.

In this case, the Court of Appeal had applied a subjective interpretation and came to the conclusion that Art. 6.1 SPA corresponds to the "real common intention" of the parties. The Federal Supreme Court pointed out that the Purchaser had not criticized the "method of interpretation" applied by the Court of Appeal in principal, but merely reiterated its own prior arguments. This might be seen as a hint that the Federal Supreme Court would have potentially been willing to scrutinize the decision handed down by the Court of Appeal more thoroughly if the Purchaser had pleaded that the method of interpretation applied by said Court was misguided and that the contract should have been interpreted in an objective manner. In the case of an objective interpretation, there could have potentially been additional arguments made to challenge the decision of the Court of Appeal.

Other sources presenting the case

Judith Rothen / Dario Galli / Markus Vischer, Leistungs- und Sicherungsversprechen in Aktienkaufverträgen, in: dRSK, published on June 7, 2021,

https://www.walderwyss.com/user_assets/publications/210607-Leistungs-und-Sicherungsversprechen-in-Aktienkaufvertragen.pdf

Christoph Brunner / Dario Galli / Markus Vischer, Die Rechtsprechung des Bundesgerichts zum Kaufvertragsrecht im Jahr 2020, in: Jusletter November 29, 2021

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[1] In the French original text « Compte tenu du risque procédural potentiel présenté par la demande en paiement formée contre W. SA par M.U., le vendeur s'oblige à garantir ce risque envers l'acquéreur par la remise d'une garantie bancaire de premier ordre à hauteur de 850'000 fr. qui sera maintenue jusqu'à droit jugé de manière définitive et exécutoire, mais qui sera totalement libérée au plus tard le 28 février 2012, en tout état et sans autre condition. Dans l'hypothèse où W. SA succomberait dans cette procédure, ladite garantie serait libérée à due concurrence des montants mis à sa charge […].»