

## How to prove the damage allegedly suffered by a purchaser for overpriced shares of a target company?

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To establish the damage suffered by a purchaser of shares of a target company based on an inaccurate financial audit report requires to allege and prove the hypothetical financial situation of the purchaser had the damage not occurred as well as what decisions the purchaser would have made if it had been aware of the correct financial value of the target company.

Judgment of the Federal Supreme Court of 9 November 2022

Case Reference : [4A\\_480/2021](#)

### Facts

When contemplating to purchase the shares of a company ("the Target Company"), a prospective purchaser ("the Purchaser") requested an accounting firm ("the Agent") submit a financial audit report of the Target Company's accounts as at December 31, 2010 ("the Report"). In the Report, the Agent confirmed that the audit had not revealed any factors that might call into question the accounting methods used to prepare the provisional financial statements of the Target Company as at December 31, 2010. A few weeks later, the Purchaser offered a price of EUR 4,000,000 to the shareholder of the Target Company ("the Seller"), instead of the sale price of EUR 4,500,000 set by the Seller, stating the risks inherent to the Target Company's activity, particularly at a geopolitical level.

It subsequently became apparent that the Target Company's financial situation was significantly less positive and as a result required a significant adjustment, with a difference in equity of approximately CHF 2,000,000. After negotiation, the Target Company accepted to pay back CHF 1,500,000 to the Purchaser in full and final settlement, without admission of liability. Arguing that the Agent had failed to identify several accounting errors which led the Purchaser to pay an inflated acquisition price of the Target Company, it sued the Agent before the Geneva First Instance Court, claiming the payment of around CHF 2,400,000 (whereby the proceedings also involved other parties, specifically a third party company that had worked together with the Agent on the Report).

A judicial expertise concluded that the Agent had failed to exercise due diligence while establishing the Report and that the Purchaser suffered damage resulting from an excessive acquisition price that was due to accounting errors in the Report. Despite the findings of the Report, both the First Instance Court and the Court of Appeal rejected the claim of the Purchaser.

### Issue

The Federal Supreme Court had to determine whether the Purchaser had validly established the damage that it had allegedly suffered as a result of the inflated purchase price paid for the acquisition of the shares of the Target Company based on the Report.

### Decision

An agent is liable to the principal for the diligent and faithful performance of the business entrusted to him or her ([Art. 398 para. 2 SCO](#)). In the context of a judicial action, the principal has to allege and prove a violation of the duty of care, a fault, a damage and a (causal and adequate) link between the violation of the duty of care and the damage. In this context, the damage suffered corresponds to the difference between the current state of assets and the hypothetical state that the assets would have had without the harmful event (so-called "Difference Theory").

According to the reasoning of the Court of Appeal, which was upheld by the Federal Supreme Court, the Purchaser had

sufficiently alleged the current amount of its assets, but had not alleged the amount of the latter in the event that the harmful event had not occurred. In order to do so, it would have had to indicate what decisions it would have taken if the harmful event had not occurred, i.e. if it had known the correct financial situation of the Target Company for the 2010 accounting year. In other words, the Purchaser would have had to establish whether it would have purchased the shares of the Target Company for a lower amount or whether it would have renounced the acquisition. On this basis, the Purchaser could have alleged its damage in a manner consistent with the legal concept of damage. The judicial expertise, which was based on the plaintiff's allegations, only stated the acquisition value of the company, the actual value of the company as at December 31, 2010, and the difference between these two values.

In this case, instead of alleging and proving these elements in accordance with [Art. 55 SCPC](#) and [Art. 8 SCC](#), the Purchaser focused on establishing its own current asset value and the actual value of the Target Company as at December 31, 2010. However, the latter parameter, which does not allow for the establishment of the hypothetical state of assets of the Purchaser that would have existed without the harmful event (i.e. without the acquisition of the Target Company at the inflated price), is irrelevant in the context of the Difference Theory. For the same reasons, the argumentation of the Purchaser in relation to the payment of an inflated price instead of the actual price was deemed irrelevant, as these concepts do not shed light on what the parties would have actually agreed.

Under these circumstances, the Federal Supreme Court found that the Purchaser had failed to allege and prove the damage resulting from the purchase of the Target Company. It also held that the judicial expertise tended to prove an irrelevant fact (i.e. the actual value of the Target Company), thus its findings were legitimately disregarded by the lower courts.

## Key takeaway

According to the difference theory, the damage incurred by a principal due to a violation of duty of care by the agent corresponds to the difference between the principal's current state of assets and this state of assets had the harmful event not occurred. In the context of inaccurate financial audit reports prepared in view of the acquisition of a company, purchasers should notably allege and prove the decisions they would have made if they were aware of the correct financial situation of the target company.

## Comments

This decision is another example of the well-established "difference theory", this time in the context of a corporate acquisition. It is also a good reminder of the burden of allegation and proof on the principal seeking compensation, especially as regards the damage suffered. From a procedural perspective, the corresponding allegations should be made and offered to prove in the briefs filed with the court, that is to say at the very beginning of the proceedings. As the decision at hand makes clear, a judicial expertise concluding the existence of a damage is of no use if it is based on irrelevant allegations. This highlights the importance for parties (and particularly for the party claiming to have suffered damages) to make sure that their allegations and the judicial expertise cover all issues that are legally relevant.

Even if it was not further developed by the Federal Supreme Court, it would appear from the decisions handed down by the lower jurisdictions that the link between the violation of duty of care and damage was also subject to debate. For such link to be admitted in the case at hand, the price of the acquisition of the target company should have been influenced by the inaccurate financial audit report. The first instance court rejected this hypothesis, on the ground that the price had been set based on considerations unrelated to the financial audit report (e.g. the geopolitical situation on a relevant market for the business of the target company). By contrast, the court of appeal admitted the influence of the financial audit report on the price of the acquisition, given that the price had been calculated in relation to the company profits.

## Other sources presenting the case

David F. Braun, Tribunal fédéral 4A\_480/2021 (<https://publications-droit.ch/files/arrets/rcassurances/12-23-fevrier-4a-480-2021.pdf>).

Dario Galli / Markus Vischer, Schadensberechnung beim Unternehmenskauf in RSDA 2023, p. 256 ff.

Markus Vischer / Dario Galli, Unrichtige Due Diligence-Berichte und ihre Folgen bei einem Unternehmenskauf in dRSK Weblaw, published on May 5, 2023 ([https://www.walderwyss.com/user\\_assets/publications/Unrichtige-Due-Diligence-Berichte-und-ihre-Folgen-bei-einem-Unternehmenskauf.pdf](https://www.walderwyss.com/user_assets/publications/Unrichtige-Due-Diligence-Berichte-und-ihre-Folgen-bei-einem-Unternehmenskauf.pdf)).

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