CENTRE DE DROIT
BANCAIRE ET FINANCIER

Conflict of interest

Foundation did not validly approve the investment

Par Célian Hirsch le 21 February 2024

Members of the Board of Trustees must recuse themselves from all decisions in which they have a conflict of interest. Their knowledge cannot therefore be imputed to the foundation. This is one of the conclusions reached by the Swiss Federal Supreme Court in ruling 4A_350/2023 of November 21, 2023.

A securities dealer (now called a securities firm, cf. art. 41 LEFin) provides asset management services for private and institutional clients. In particular, it manages the assets of a BVG pension fund. The CEO of this asset manager and one of his employees are also members of the foundation's board. The majority of the foundation's assets are invested in two funds of funds (a fund of funds is a fund that invests in other funds). These funds of funds are managed and distributed by the manager. The manager is therefore in a "dual role", managing both the foundation's assets and the fund of funds. He does not actively inform the foundation of this situation.

In a lawsuit brought against the manager, the foundation claims in particular that he has caused it damage due to the unnecessary costs caused by the funds of funds. Indeed, the manager could have directly purchased units of the target funds, thus avoiding the fund-of-funds fees. It is also demanding an accounting of the retrocessions received from the target funds (for this aspect, see Ollivier, cdbf.ch/1327). The Zurich Handelsgericht upheld the foundation's claim for payment, but reduced the amount by half due to the foundation's concomitant fault.

In its reasoning, the Zurich court noted that, from July 2009 onwards, the asset manager found himself in a conflict of interest situation due to his dual role in the investment of the foundation's assets and in the fund of funds. He received asset management fees from both the foundation and the fund of funds management company. The result was an incentive to invest the foundation's assets in the fund of funds and to leave them there, with the risk of no longer being guided by the sole interests of the foundation in his investment decision. However, the fund manager did not inform the foundation of this conflict of interest, nor of the higher costs of fund-of-funds and the disadvantages and supposed advantages compared with investing directly in the target funds. The foundation was therefore unable to validly approve the disputed investment, which was necessary given the manager's conflict of interest. It must therefore be compensated for the excessive costs resulting from this investment.

The investment manager is appealing to the Swiss Federal Supreme Court. In particular, he argues that certain members of the Board of Trustees were aware of this situation, as they were

also employees of the manager. They would therefore have validly approved the disputed investment.

Under art. 55 para. 2 of the Swiss Civil Code, the corporate bodies bind the legal entity by their legal acts and by all other facts. It follows that, in principle, the legal entity must also rely on the knowledge of its organs (imputation of knowledge). However, this knowledge is not imputed absolutely. The only knowledge imputed to the legal entity is that which is objectively accessible within its organization (functional approach to imputation of knowledge).

The Handelsgericht held that, as a general rule, the legal entity should not be imputed knowledge of a person who is in a conflict of interest situation. The Federal Court expressly leaves this general question open, but accepts its application in this particular case. It held that approval of an investment made in breach of contract – in casu in a conflict of interest – requires informed consent (informierte Genehmigung). In this case, the members of the Board of Trustees who were in a conflict of interest should have recused themselves from any decision relating to the investment in the fund managed by the fund manager ; their knowledge cannot therefore be taken into account for any informed approval of this investment. Consequently, the foundation could not validly approve the disputed investment, as it lacked the knowledge necessary for such approval.

The judgment is convincing. An investment that is contrary to the duty of loyalty cannot be validly approved by the investor's governing bodies who find themselves in a conflict of interest situation, particularly when they are also governing bodies of the asset manager. Formulated in more legal terms, the functional approach to imputation of knowledge is opposed in casu to imputing to the legal person the knowledge of the organ in a situation of conflict of interest.

However, this conclusion should not be over-generalized. Indeed, the Federal Court has expressly left open the question of imputation of knowledge in the event of a conflict of interest on the part of the corporate body (cf. cep. 4C.332/2005 c. 3.3 in fine). The Federal Court (sitting with 3 judges) confined itself to deciding the case in point, in which the manager must necessarily have been aware of the conflict of interest in which the members of the Board of Trustees found themselves, since one of them was the CEO of the manager. Moreover, for the same reason, the manager was also aware that the Board of Trustees had never held an in-depth discussion on the advantages and disadvantages of the fund of funds, in comparison with direct investments in target funds, and on the manager's dual role. The Handelsgericht even concluded that the manager was not acting in good faith when he invoked the foundation's approval of the investment.

For a critical analysis of the imputation of knowledge of a legal entity, see Fournier Annick, L'imputation de la connaissance, Étude de droit privé suisse, thesis Fribourg, Zurich 2021.
