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WENFEI ATTORNEYS-AT-LAW LTD.

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The Swiss Investment Report is especially designed for Chinese Investors, who are intending to extend their business to Switzerland or Europe or are already doing business in Switzerland.

The Swiss Investment Report provides background information on the Swiss investment-related legal framework as well as information on current developments in the Swiss legislation from a foreign investor's perspective.

Protections for bank customers – the new judgment by the Swiss Federal Supreme Court regarding "executive-only" contracts

I. New Judgement by the Federal Supreme Court

The following article will analyse the new judgment by the Swiss Federal Supreme Court regarding a bank customer who has become the victim of misconduct by a bank employee. It aims to discuss and explain different scenarios, and in each situation which legal provisions could provide what kind of protections for the bank customer against the misconduct of a bank.

The ruling was about an "execution only" relationship that a bank customer had entered into with a bank in Geneva. Under this "executive-only" contract, neither an asset management nor an investment advisory mandate was concluded. The bank employee made numerous transactions on the bank client's account without his consent. Among these 12 transactions, there were gratuitous transfers to third parties without consideration, transfers with consideration in return for shares, share purchases, and forex transactions. Apart from one exception, these transactions all resulted in losses for the customer. The internal investigation found that there had been illegal activities and fraud such as using customer funds for personal purposes of the bank employee.

The Federal Supreme Court first reiterated its case law regarding the qualification of the banking relationship:

- A bank that carries out banking transactions without the instructions or consent of the customer, is liable for any resulting damage to the customer according to the rules of management without mandate (Art. 419 et seq. Swiss Code of Obligations, hereinafter the "**CO**");

- The non-performance or poor performance of the orders placed by the customer to buy or sell securities is subject to the rules of the commission contract.

II. Bank employee acts without instructions or customer's consent

The Federal Supreme Court considered that if a bank employee embezzled customer balances, which were carried out without instructions and without the customer's consent, the customer suffered the damage and the bank is liable under Art. 398 Para. 2 and Art. 97 et seq. CO.

In such a situation, neither the “management without mandate” rule (Art. 419 et seq. CO) (perfect or imperfect) nor the rules on commission contract could be applied directly. Rather, it is a matter of illegal acts under Art. 41 CO committed by an employee of the bank. While the customer enjoys the combination of tortious and contractual action, the bank is contractually liable for the acts of its auxiliary person in accordance with Art. 101 CO. According to the Federal Supreme Court, the bank is liable even if it is its employee’s actions that are unlawful, because it is sufficient for the auxiliary person to cause an action in the performance of their work under Art. 101 Para.1 CO, that is, the general scope of the auxiliary person's duties by virtue of a functional connection. More specifically, although the commission of a tort is never an actual task of an employee, there is nevertheless a functional connection as soon as the act committed falls within the general framework of his activities.

Therefore, if a bank employee embezzled customer balances, which were carried out without instructions and without the customer's consent, it is a breach of the bank's duty of care and loyalty. This allows the customer to file for a liability action under Art. 398 Para. 2 CO in conjunction with Art. 101 CO, not an action for performance.

According to the Federal Supreme Court, the damage for liability action can be claimed according to the Swiss “difference theory” which indicates, that the claimed damage corresponding to the difference between the current state of wealth and the state that the wealth that he would have had, if the damaging event did not occur, in other words, his losses, has to be proved.

If the damage can be calculated precisely under Art. 42 para. 1 CO, a seek for compensation for the damage suffered as a result of the non-performance of

the contract, or a violation of Art. 42 para. 2 CO, will be dismissed according to the Federal Supreme Court.

III. Lack of Legitimation

Those cases of unauthorised acts, which would trigger the bank's contractual liability, should be distinguished from cases in which the bank makes deposits or transfers from the customer's account to a third party because it does not know the lack of legitimation of the customer or the existence of a forgery was not recognised.

According to case law, a lack of legitimation or undetected forgeries, as well as the insolvency of the customer are among the risks inherent in the banking business. These are exceptions to the general regulation of contractual liability in Art. 398 Para. 2 and Art. 97 et seq. CO.

The case remained reserved where the parties had agreed on a risk transfer clause in analogous application of Art. 100 and Art. 101 (3) CO, according to which the risk was transferred from the bank to the customer, provided that the bank had not acted with gross negligence.

IV. Contributory Negligence

If contributory negligence of the bank client can be proven, according to the Federal Supreme Courts case law, it could interrupt the adequate causal link or reduce the damages to which he was entitled.

- Scenario 1: The claimant had no reason to expect unusual elements and no reason to question the explanations given to him. According to the Cantonal Court of Geneva and confirmed by the Federal Supreme Court, if the claimant had had no reason to expect unusual elements and no reason to question the explanations given to him, no contributory negligence of the claimant is given.

Especially for “execution-only” type banking relationships, the clients have no reason to expect unusual behaviour and elements on their accounts. Therefore, it cannot be claimed that the client did not look at his bank storage

documents and summaries given by a bank employee carefully and therefore the client is partly to blame.

The bank can also not rely on a lack of diligence on the part of the client in inspecting his bank correspondence, especially if the given mistakes were made by the bank employee and the bank's failures to supervise its employees and manage the client's files.

Additionally, the client cannot be accused of not having reacted to falsified account statements, if he had no reason to question the explanations given to him by the bank employee.

The costumers trust the bank and its official regulations and it would be arbitrary to expect every bank customer to precisely read and check all documents and bank statements.

- Scenario 2: The client should have suspected unusual behaviour

But even if, the claimant had no reason to expect unusual elements, this element has limits. If proven that the bank client had known or should have suspected that unusual behaviour was happening.

If a bank client has discovered some unusual behaviour, like suspicious transactions, it can be expected that the client, as any other reasonable person in the same situation, checks on whether there are any other unusual transactions without authorisation.

As such, contributory negligence of the bank client can be proven and might reduce the damages to which he was entitled.

However, the court needs to determine, on the basis of the established facts, at what point and under what circumstances the bank client had known or should have suspected that unusual activities without his instructions were taking place. Accordingly, the Court needs to assess at what point the bank client could and should have reacted by inquiring directly with the bank. Consequently, only in this way, it can be analysed which cases of fraud could have been prevented.

V. Summary

The Supreme Court acknowledged that in cases where a bank employee embezzled customer balances, without instructions and without the customer's consent, the customer suffered the damage and the bank is liable under Art. 398 Para. 2 and Art. 97 et seq. CO. Because this behavior is a breach of the bank's duty of care and loyalty, it qualifies the customer for a liability action under Art. 398 Para. 2 CO in conjunction with Art. 101 CO.

A contributory negligence of the client could interrupt the adequate causal link or reduce the damages to which he was entitled. But contributory negligence can only be confirmed, if the client should have suspected unusual behaviour. This provides wider protection for a bank client because, in general, bank clients have a lot of trust in the bank and its official regulations, and would never expect unusual behaviour. A different ruling regarding these regulations could shatter the trust and mean excessive expectations for bank customers to precisely read and check all documents and bank statements.

In conclusion, bank customers are encouraged to regularly inspect the trading records on their accounts to make sure no unauthorised transactions are carried out without their knowledge and authorisation, although in any case, it is not under their responsibility to check everything in detail and be expected to discover any illegal acts.

The customers should also heed the contributory negligence rule, under which the causal link between the bank and the damage could be interrupted, or the damages to which the customer is entitled could be reduced, in cases where the customer is well-aware of the illegal acts of the bank employee without any intervention.

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