Restructuring procedures in Switzerland

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discuss the Swiss legal restructuring and insolvency regime

Though the Covid-19 pandemic situation has improved faster than anticipated, the Swiss federal government's expert group lowered its 2022 growth forecast for gross domestic product in Switzerland to 2.6% in its last forecast in June 2022.

According to the expert group, the Swiss economy started in relatively good shape in 2022, with the domestic economy on the rebound and with a strong performance in the labour market.

However, the group expects significant effects due to the Ukraine conflict in connection with the considerable increase in prices of key exports from Russia and Ukraine (e.g., energy resources) and the high global inflationary pressures. It points out the increased uncertainty weighing on the investment climate and the growing issues in global supply chains.

Given the uncertainties, the increase in interest rates, and the fact that there remain questions regarding the development of the pandemic, it remains to be seen whether and at what pace the Swiss economy will continue to rebound.

Even though uncertainty remains regarding the development of the pandemic situation, most of the government support measures for businesses that were put in place during the Covid-19 pandemic have come to an end. In cases of financial distress, businesses will thus in general no longer be able to rely on extraordinary support measures from the government in 2022.

While the government's pandemic-related support measures were only temporary, there are some permanent changes to the legal restructuring and insolvency legal regime which have recently been implemented. These include:

- The extension in 2020 of the maximum duration of the provisional debt moratorium (which is the first stage of the composition proceedings, as explained below) from four to eight months;

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- The abolition of the corporate law moratorium (effective from January 1 2023); and
- Certain changes and clarifications regarding the duties of directors of Swiss companies in distress situation (effective from January 1 2023).

Framework

Corporate restructuring and insolvency proceedings in Switzerland are mainly governed by the Swiss Debt Enforcement and Bankruptcy Law (DEBA).The DEBA provides for two main types of proceedings: (i) bankruptcy proceedings; and (ii) composition proceedings, which are the main Swiss restructuring proceedings.

In addition to the composition proceedings provided for by the DEBA, the Swiss Code of Obligations provides for a second type of restructuring proceedings, the corporate law moratorium, which is abolished as of January 1 2023. Often, however, distressed corporate debtors in Switzerland try to restructure without the involvement of the courts and thus outside of composition proceedings.

The composition proceedings were improved less than 10 years ago, the Swiss international insolvency law was modernised a few years ago and some changes and clarifications regarding the duties of the directors of Swiss companies in case of financial distress are coming into force on January 1 2023. Given these developments, there are no significant debates now taking place with respect to the Swiss corporate restructuring and insolvency framework.

Note, however, that – even though improved – the composition proceedings in practice do not have the same significance in Switzerland as in-court restructuring proceedings in other jurisdictions, such as Chapter 11 in the United States.

As mentioned, distressed corporate debtors in Switzerland typically try to restructure without the involvement of the courts. If no out-of-court restructuring can be achieved, distressed debtors increasingly try to save their business by way of a pre-pack.

In a pre-pack, the sale of the business is privately negotiated and signed, subject to the approval of the composition court. The distressed debtor then applies for composition proceedings and the pre-negotiated deal is proposed to the composition court for approval once composition proceedings have been opened.

Upon approval by the composition court, the sale is completed, and the distressed legal entity is liquidated. The advantage of such a pre-pack is that no fraudulent conveyance claims can be brought against such a sale.

A recent decision by the Federal Swiss Court in 2021 confirmed the liberal practice of the lower Swiss courts regarding such pre-packs and also set narrow limits on the possibility of creditors to challenge such pre-packs. It is expected that this confirmation by the Federal Swiss Court will further help to establish pre-packs as one of the important restructuring tools in Switzerland.

Processes and procedures

Overview

As mentioned above, as from January 1 2023 there remain two corporate restructuring and insolvency processes available in Switzerland:

1) Bankruptcy proceedings, which lead to the dissolution of the debtor and the objective of which is the liquidation of the debtor's estate and the proportionate satisfaction of the debtor's creditors by classes through the distribution of the

"As governmental support relating to Covid-19 comes to an end, companies may face financial issues."

proceeds. Bankruptcy proceedings are opened by the bankruptcy court either upon the request of the debtor itself or of a creditor. The debtor's board of directors has the duty to request the opening of bankruptcy proceedings in the event of over-indebtedness. Furthermore, the debtor may request the opening of bankruptcy proceedings if it declares itself illiquid. A creditor may request the opening of bankruptcy proceedings if it has gone through the ordinary Swiss debt collection proceedings and its claim has not been settled by the debtor (and, in certain cases, even without prior debt-collection proceedings).

2) Composition proceedings, which protect the distressed debtor from its creditors to enable the debtor either to attempt to reach a court-approved debt-restructuring agreement (so-called composition agreement) with its creditors or to restructure outside a court-approved debt-restructuring agreement. The composition agreement can either take the form of (i) an ordinary composition agreement, in which the debtor and its creditors agree either on a specific payment plan, a haircut, or a combination thereof (and thus the survival of the debtor), or (ii) a composition agreement with assignment of assets, which provides for the assignment of the debtor's assets to its creditors for realisation by a liquidator elected by the creditors in satisfaction of the creditors' claim and which leads to the dissolution of the debtor. Composition proceedings are usually opened by the composition court upon request of the debtor itself, though creditors may under certain circumstances also request the opening of composition proceedings.

Swiss insolvency law does not provide for special treatment for group insolvencies. Every entity is therefore treated in a separate proceeding, though the DEBA at least requires that composition proceedings and bankruptcy proceedings over different group companies are coordinated.

Selected topics

Impact of the opening of proceedings on creditors

The main effect of the opening of proceedings on claims of creditors differs depending on whether bankruptcy proceedings or composition proceedings are opened:

1) Subject to certain exceptions, the main effects of the opening of bankruptcy proceedings on claims of creditors are that (i) all obligations of the debtor become due, (ii) interest ceases to accrue, (iii) non-monetary claims and claims de-nominated in a foreign currency are converted into monetary claims of corresponding value in Swiss francs, (iv) claims against the debtor are not enforceable anymore outside such bankruptcy proceedings and are satisfied according to the ranking of their claims (see below), and (v) pending court proceedings are automatically stayed. Security or individual enforcement actions against the debtor are terminated and the respective claims have to be filed in the bankruptcy proceedings. While pledged assets of the debtor form part of the bankruptcy estate, the preferential rights of the secured creditors remain reserved.
2) Subject to certain exceptions, the main effect of the opening of composition proceedings – which start with the granting of a debt moratorium, whose aim is to protect the distressed debtor from its creditors – on claims of creditors are the following: (i) enforcement

"Though the regime for in-court restructurings has been improved, there is still room for improvement."

proceedings can neither be initiated nor continued (including enforcement of pledges), (ii) court proceedings are automatically stayed, (iii) interest ceases to accrue for unsecured claims, and (iv) during the debt moratorium, limitation periods and deadlines leading to the forfeiture of rights do not run. However, the granting of the debt moratorium does not result in any acceleration of the debt, contracts are not automatically terminated, and there is no automatic conversion of debt into monetary claims of corresponding value in Swiss francs. Furthermore, contractual termination rights are generally not affected. During the debt moratorium, however, contracts for the performance of a continuing obligation may be terminated at any time by the debtor, subject to certain conditions.

Sale of a distressed debtor's business

The sale of the distressed debtor's business or part of it can be executed outside court proceedings. The main downside to this is that such a sale may be challenged in a subsequent insolvency of the distressed debtor with the argument that the purchase price was not adequate i.e. it was too low.

Such a sale outside court proceedings has further downsides, such as the inability to cherry-pick employees and a joint liability of the acquirer for certain claims of employees.

Such sales are therefore increasingly executed within composition proceedings by way of a pre-pack (as described above) to avoid these issues. Alternatively, a transfer of the debtor's business or part of it could also be implemented in the context of a composition agreement with assignment of assets (e.g. transfer to a new company held by the creditors or to a third-party buyer).

Duties of directors of a company in financial distress

Based on the directors' duty to safeguard the interests of the company, their main duty in case of financial distress is to ensure the continuing existence of the company by implementing the necessary restructuring measures.

In addition to this general duty, Swiss company law provides for certain specific duties of the directors, which are triggered by the company's balance sheet situation:

1) If, according to the company's stand-alone statutory balance sheet, the net assets no longer cover half of the company's capital and legal reserves, the directors must promptly call a shareholders' meeting and propose restructuring measures.
2) Furthermore, if there is substantiated concern that the company is overindebted, an audited interim balance sheet must be prepared. If the (interim) balance sheet shows that the claims of the company's creditors are neither covered by its assets on a going-concern basis nor on a liquidation-value basis, the directors must file for bankruptcy or composition proceedings. The directors may only refrain from notifying the judge if either (i) the company's creditors subordinate their claims to those of all other creditors in the amount necessary to cure the over-indebtedness, or (ii) the directors immediately take measures to reorganise the company and it seems reasonable to believe that such reorganisation can be achieved within a short time frame (four to six weeks grace period).

Though such specific duties of the directors are only tied to the balance sheet situation of the company, the company's liquidity usually plays a decisive role as to whether such duties are triggered. According to Swiss accounting rules, a company's financial accounting must switch from going concern to liquidation values if the continuation of the company's business activities during the next 12 months is likely not to be possible (i.e. no going concern). This is in particular the case if the company does not have sufficient liquidity (or access to liquidity) for such a time period.

The switch from going concern to liquidation values typically leads to an over-indebtedness and thus triggers the duty to notify the judge. A key focus of the directors in a distress situation must therefore be the liquidity situation of the company: they have to constantly monitor (but also conserve and obtain access to) liquidity and, if it is not in place, implement a monitoring system that allows visibility of the liquidity situation (actual and over 12 months on a rolling basis).

The rules set out above will be slightly amended from January 1 2023, in particular to include an explicit duty of the board to restructure the company in case of illiquidity.

Cram down

The possibility of a cram down exists in the context of composition proceedings. If a composition agreement is approved by the majority of the unsecured and unprivileged creditors representing at least two-thirds of their claims (or by one-quarter of such creditors representing at least three-quarters of their claims) and by the court, it is binding on all creditors (other than privileged creditors, secured creditors up to the value of their collateral and creditors whose claims came into existence during the composition proceedings with the approval of the administrator).

Not possible, though, is a cram down in the context of composition proceedings with respect to an entire class of creditors. The provisions of Swiss law governing bonds also provide for the possibility of a cram down.

Challenging a debtor's transactions

The DEBA provides that the following transactions carried out by a debtor before the opening of insolvency proceedings can subsequently be challenged by the

insolvency administration (or under certain circumstances by creditors) in the insolvency proceedings and can be voided by the court (fraudulent conveyance claim):

1) Gifts and gratuitous transactions, as well as dispositions made by the debtor without receiving adequate consideration during the year prior to the opening of insolvency proceedings.
2) The following acts are voidable if carried out by the debtor during the year prior to the opening of insolvency proceedings, if the debtor at that time was already over-indebted (recognisable for the counterparty): the granting of collateral for existing obligations that the debtor was hitherto not bound to secure, the settlement of a (monetary) debt by unusual means of payment, and the payment of a claim before it falls due.
3) Finally, any act that has been carried out by the debtor during the five years prior to the opening of insolvency proceedings is voidable if it has the purpose, apparent to the other party, of disadvantaging its creditors or preferring certain of its creditors to the detriment of others.

Priority claims and protection for post-petition credit

In bankruptcy, proceeds are distributed as follows:

- First, secured creditors are satisfied out of the proceeds from the realisation of their collateral.
- Then, creditors having claims against the bankruptcy estate itself (i.e., claims that have come into existence with the consent of the bankruptcy administration) are satisfied.
- Finally, creditors with unsecured claims are satisfied out of the remaining proceeds of the liquidation of the estate according to the class their claim has been allocated to. There are three classes of claims. First-class claims are mainly claims of employees of the debtor. Second-class claims are certain claims by social security, health, and unemployment insurance institutions. Third-class claims are all other claims. Creditors of an inferior class only participate in the distribution if all creditors of the superior classes have been entirely satisfied. If the proceeds are insufficient to satisfy all creditors of the same class, the available amount will be distributed among them in proportion to the amount of their respective claims.

In the case of composition proceedings, the following rules apply:

- The composition agreement is binding on all creditors, except for privileged creditors (i.e. first- and second-class claims), secured creditors up to the value of their collateral and creditors whose claims came into existence during the composition proceedings with the approval of the administrator, all of which must be covered to obtain court approval for a composition agreement.
- If no composition agreement can be reached and bankruptcy proceedings are opened, the claims of creditors, which came into existence during the debt moratorium with the consent of the administrator, are treated like claims that have come into existence with the consent of the bankruptcy administration.

Post-petition credit is thus protected in bankruptcy due to the priority it has over all other claims (except secured claims). In the case of a composition agreement, post-petition credit is also protected, as a composition agreement can only be approved by the court if the full payment of such claims is ensured.

Special insolvency regimes

Swiss law provides for special rules in particular with respect to banks, securities firms, insurance companies, collective investment schemes and fund managers, where the Swiss Financial Market Authority (FINMA) plays a decisive role.

Swiss law also provides for special rules with respect to railway and shipping companies.

Cross-border cases

In the case of a restructuring or insolvency proceedings over a foreign corporate debtor that has assets located in Switzerland, the following applies:

1) Foreign bankruptcy decrees as well as foreign restructuring decrees and proceedings need to be recognised in Switzerland in order to deploy any effect in Switzerland. According to the Swiss International Private Law (PILA), such foreign decrees and procedures are recognised in Switzerland upon application if the following cumulative conditions are met: (i) the foreign decree is issued at the debtor's domicile or centre of main interests, (ii) the decree is enforceable in the country in which it was issued, and (iii) there are no grounds for non-recognition (e.g. non-compatibility with Swiss public policy).
2) However, if a foreign decree or proceeding is recognised, such recognition does not result in the foreign administrator being able to include the Swiss assets of the debtor in the foreign proceedings, or to conduct the foreign proceedings on Swiss territory. Such recognition leads to the opening of Swiss auxiliary proceedings with a Swiss administrator regarding the debtor's Swiss assets, which is conducted for the benefit of certain creditors. In bankruptcy proceedings, only a surplus is remitted to the foreign bankruptcy estate subject to certain conditions being met.
3) The court can, however, upon request renounce having auxiliary proceedings carried out under certain circumstances. In such a case, the foreign administrator may, subject to Swiss law, exercise all powers to which they are entitled under the laws of the state in which the proceedings were opened (including transferring assets abroad and conducting litigation), except for the performance of sovereign acts, the use of coercive measures, or the right to settle disputes.

Looking ahead

As most governmental support measures relating to the Covid-19 pandemic have come to an end, a considerable number of companies in Switzerland may face financial issues and an increased need to restructure, either operationally or from a liquidity or balance sheet point of view, unless the government decides to grant further reliefs.

Further, given the decision of the Federal Swiss Court regarding pre-packs, the trend to save businesses of distressed debtors by way of pre-packs in the context of composition proceedings is likely to continue.

Though the regime for in-court restructurings has been improved in Switzerland over the past decade, there is still room for improvement. In particular the fact that Swiss insolvency law does not provide for a special treatment for group insolvencies and that each Swiss group entity is therefore treated in a separate proceeding is a considerable impediment to restructurings. The introduction of rules regarding group restructurings would therefore considerably facilitate restructurings of entire groups.