Turbulent times: navigating Switzerland's expected rise in corporate distress

Christoph Neeracher, Luca Jagmetti and Thomas Rohde
of Bär & Karrer discuss Switzerland's restructuring and insolvency landscape for 2023 and beyond

Though Switzerland's GDP grew substantially in the first few months of 2023 and energy prices continue to fall, the Swiss federal government's expert group expects significantly below average growth for the Swiss economy in 2023 in its latest forecast, with a GDP growth rate of 1.1%. According to the expert group, comparatively high inflation rates are to be expected in the short-term in Switzerland, with a stabilisation at 2.3%, as the dampening effects of declining energy prices are offset by continuing price pressure in other areas. Nevertheless, a modest growth in consumption is expected in 2023 bolstered by a solid labor market.

According to the expert group, domestic demand will be the main pillar of growth in 2023 and not foreign trade, given the internationally high inflationary pressures and restrictive international monetary policy. The expert group, however, highlights the persisting economic risks and does not exclude that, in case of a severe energy shortage in Europe this winter, with large-scale production losses and a significant downturn, a recession twinned with high price pressure could hit Switzerland.

Given the rising costs of interest and the general weakness of the global economy, a further rise in corporate distress is to be expected in Switzerland, and thus a further rise in restructuring activity. However, unless a recession hits Switzerland, such a rise in corporate distress will still be at a moderate level.

Christoph Neeracher
Partner
Bär & Karrer
E: christoph.neeracher@baerkarrer.ch

Christoph Neeracher is a partner of Bär & Karrer in Zurich and heads the private M&A and private equity practice. Christoph specialises in international and domestic M&A transactions (focusing on private M&A and private equity transactions, including distressed equity), corporate restructurings, corporate law, general contract matters (e.g. joint ventures, partnerships and shareholders agreements) and all directly related areas such as employment matters.

Luca Jagmetti
Partner
Bär & Karrer
E: luca.jagmetti@baerkarrer.ch

Luca Jagmetti is a partner of Bär & Karrer in Zurich. Luca co-heads Bär & Karrer's reorganisation and insolvency practice. He specialises in private M&A transactions, corporate restructurings and insolvency matters and general corporate, commercial and employment matters, including related litigation and administrative proceedings.

Thomas Rohde
Partner
Bär & Karrer
E: thomas.rohde@baerkarrer.ch

Thomas Rohde is a partner of Bär & Karrer in Zurich. Thomas co-heads Bär & Karrer's reorganisation and insolvency practice, focusing on corporate restructurings and reorganisations as well as the representation of creditors in Swiss insolvency proceedings. He also frequently advises clients on all types of M&A transactions as well as on general corporate and commercial matters.

Recovery

In terms of restructuring transactions in Switzerland over the past 12 months, the rescue of Credit Suisse Group AG by way of the state-facilitated merger into UBS Group AG is certainly the most prominent one. However, this restructuring transaction was unique in many ways, not only in terms of challenges, which had to be addressed, but also in terms of the toolbox used for the rescue. The transaction was facilitated, and potential obstacles cleared, by way of issuance of an emergency ordinance by the Swiss government.

Apart from this exceptional restructuring transaction, the general restructuring activity over the past 12 months indicated the continuation of two trends: the use of composition proceedings (i.e., the Swiss in-court restructuring proceedings) for Swiss-style pre-pack transactions, and the use of the composition proceedings for a wind-down of the distressed debtor's business and thus a softer landing in bankruptcy. The use of composition proceedings for a restructuring of the distressed debtor itself, however, still is not too popular. This is especially in comparison with similar instruments in other jurisdictions – and distressed debtors still prefer to try to agree on an out-of-court restructuring with its stakeholders before they use the composition proceedings, which are often only used as "plan B".

Even though a rise in corporate distress and restructuring activity is expected, this will not fundamentally change over the next 12 months, and distressed debtors will continue to prefer out-of-court restructurings to in-court restructurings. However, the Swiss corporate law reform, which entered into force on January 1 2023, has limited the period within which an over-indebted debtor can attempt to achieve an out-of-court restructuring and after which the over-indebted debtor must file for composition proceedings or for bankruptcy. This new limitation will likely have a negative influence on the success rate of out-of-court restructuring attempts and the switch from out-of-court restructuring efforts to composition proceedings (and thus in-court restructuring proceedings) will now occur quicker and more often than previously.

Legislation and policy

Legal framework

Corporate restructuring and insolvency proceedings in Switzerland are mainly governed by the Swiss Debt Enforcement and Bankruptcy Act (DEBA). Several laws and ordinances other than the DEBA, however, contain additional provisions on corporate restructuring and insolvency. These either provide special rules regarding certain types of insolvent debtors (e.g., banks, securities firms, insurance companies, collective investment schemes and fund managers, as well as railway and shipping companies) or regarding specific aspects of an insolvency (e.g., the directors' duties in the event of insolvency, which are set forth in the Swiss Code of Obligations (CO)). Furthermore, the Swiss Private International Law Act (PILA) contains the relevant rules regarding recognition of foreign restructuring and insolvency proceedings and decrees in Switzerland. Not applicable in Switzerland, however, are the European regulations regarding restructuring and insolvency, as Switzerland is not member of the EU.

The DEBA provides for two main types of insolvency proceedings: bankruptcy proceedings, and composition proceedings, which are the Swiss in-court restructuring proceedings. Composition proceedings protect the distressed debtor from its creditors to enable the debtor to either

attempt to reach a court-approved debt-restructuring agreement with its creditors (the so-called "composition agreement") or to restructure outside a court-approved debt-restructuring agreement. The composition agreement can either take the form of:

- 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
- A "composition agreement with assignment of assets", which assigns 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.

Policy changes

The last major changes to the composition proceedings were implemented in 2014 and were aimed at facilitating the restructuring of financially distressed companies in the context of composition proceedings. As mentioned, even though these changes were designed to make composition proceedings more attractive, they still do not have the same significance in Switzerland like in-court restructuring proceedings in other jurisdictions, such as the Chapter 11 in the US. Often, distressed companies try to restructure without the involvement of the courts and thus outside of composition proceedings in Switzerland.

The legal framework for out-of-court restructurings is mainly contained in the CO, which sets forth the duties for directors of Swiss companies in case of financial distress and provides for most of the instruments available for balance sheet restructurings. This framework has been somewhat adjusted with the revision of Swiss corporate law, which came into force on January 1 2023:

- As was the case before the revision, the board of a Swiss company must prepare audited interim financial statements if it has a substantiated concern that the liabilities of the company are no longer covered by its assets (over-indebtedness). If such financial statements do show an over-indebtedness, the board must file for bankruptcy or, alternatively, for composition proceedings, unless creditors subordinate their claims in an amount sufficient to cover the over-indebtedness;
- According to existing case law, in case of over-indebtedness, the board can delay such a filing during a grace period of four to six weeks if it promptly implements restructuring measures and if there is a realistic prospect of financial recovery. This concept of a grace period has now been codified via the corporate law reform, and the CO now states that the board may delay the filing if there is a realistic prospect that the over-indebtedness is cured within 90 days of the receipt of the audited interim financial statements. This codification presents difficulties as the over-indebtedness must be solved within the grace period (i.e., a delay is not permitted even if the effect of the implemented measures unfolds later than 90 days or if – due to specific circumstances – a longer grace period would be adequate), and this will likely have a negative influence on the success rate of out-of-court restructurings in Switzerland;
- Codifying existing case law, the revised CO now also introduces an explicit duty of the board to supervise the liquidity of the company and, if there is a threat of illiquidity, to take appropriate measures. In this context, a provision was introduced stating that "the board files for composition proceedings if required". Legal doctrine is rightfully of the view that this provision does not introduce an additional obligation of the board to file for composition proceedings in case of impending liquidity problems. Should courts come to another conclusion, then this could trigger a shift from out-of-court restructurings to in-court-restructurings;
- The revised corporate law also clarifies that a debt-equity swap is permitted even in situations where the company is over-indebted (which was disputed by some scholars under the existing law), which will likely lead to a more widespread use of this expedient restructuring instrument; and
- The revised law also abolished the so-called corporate law moratorium (i.e., the possibility of the bankruptcy court to postpone bankruptcy to allow the debtor to implement an out-of-court restructuring), given that the composition proceedings can be used for the same goal.

In addition to the above adjustments, the rules applicable to the restructuring and insolvencies of banks have also been amended as of January 1 2023. Furthermore, a revised legislation regarding the insolvency of insurance companies, which now allows an insurance company to be restructured rather than be left to go bankrupt in case of insolvency, will come into force on January 1 2024.

Given these recent revisions, no major changes to the general restructuring and insolvency regime in Switzerland are to be expected soon.

Separately, looking back on the measures implemented by the Swiss government during the COVID-19 pandemic which have since ended, it is notable that neither the measures nor the economic impact of COVID-19 had a lasting influence on the Swiss restructuring and insolvency framework.

Foreign trends

Based on the EU directive on preventive restructuring frameworks, certain jurisdictions have recently implemented the possibility of a cross-class cramdown outside insolvency proceedings, to facilitate the implementation of a preventive debt restructuring (like the English scheme of arrangement). The introduction of such a concept is currently not being discussed in Switzerland, neither within nor outside insolvency proceedings:

- While the possibility of a cramdown exists in Switzerland for composition proceedings, the creditors, which are subject to the composition agreement, form one class and a cramdown of an entire class of creditors (i.e., against the will of most of a specific class of creditors) is thus impossible in the context of composition proceedings; and
- The possibility of a cramdown exists in Switzerland outside of composition proceedings in the context of bond restructurings. However, in such proceedings, a cross-class cramdown (in case different bonds have been issued by the same debtor and are subject to the restructuring) is neither provided for by Swiss law nor currently discussed.

Also, with respect to certain other aspects of insolvency law, where the EU is currently pushing for a harmonisation – and thus changes – across its member states, Switzerland currently does not plan to amend its rules:

- Access to beneficial ownership registers: while Swiss law obligates an acquirer of

at least 25% of the capital or voting rights in a Swiss company to disclose to the company the beneficial owner for whom the acquirer is acting, there is no separate or additional national register of beneficial ownership. As for the information collected by a Swiss company regarding such beneficial owners, such information is not generally available to officeholder, except to the officeholders of:
  (i) The company itself;
  (ii) The respective acquirer (but only with respect to its own beneficial owner(s); and
  (iii) Of the ultimate beneficial owners (but only with respect to themselves).
- Deadline for filing: as mentioned, since implementing the corporate law reform on January 1 2023, the CO imposes the duty for the board to file for bankruptcy (or composition proceedings) within 90 days of the date the interim financial statements are available which show the over-indebtedness of the company.
- Creditors committees: in Switzerland, a creditors committee may be established for ordinary bankruptcy proceedings by the first creditors meeting. Such a committee has the following competencies:
  (i) Supervision of the bankruptcy administration;
  (ii) Approval of accounts, authorisation of the continuation of court proceedings and conclusion of settlements;
  (iii) Objection to claims in the bankruptcy which the bankruptcy administration has admitted; and
  (iv) Ordering payment on accounts to be made to the creditors during the bankruptcy proceedings.

A creditors committee can also be appointed for composition proceedings by the composition court for the duration of the debt moratorium. This creditors committee must be regularly informed by the administrator of the status of the proceedings but, unlike the creditors committee in bankruptcy proceedings, it has only few competencies:
- Supervision of the administrator;
- Giving of recommendations to the administrator; and
- Authorisation of the divestment, encumbrance or pledge of certain assets which are affected to the debtor's business, or of the provision of guarantees (i.e. pledges or sureties) or gifts by the debtor.

In general, changes are currently not contemplated for the Swiss insolvency rules for corporate debtors.

While there are no major misconceptions around Swiss insolvency proceedings, it should be remembered that Swiss insolvency law does not provide for a special treatment for group insolvencies. Even though the DEBA requires that composition proceedings and bankruptcy proceedings over different group companies are coordinated, every entity is treated in a separate proceeding.

Looking ahead

As mentioned, a further rise in corporate distress and thus a further rise in bankruptcy and restructuring cases in Switzerland are expected. Regarding the latter, this applies to both in-court and out-of-court, though at a moderate level unless a recession hits Switzerland.

Further, distressed corporate debtors will continue to prefer out-of-court restructurings to in-court restructurings. But the newly-introduced 90-day period for implementing an out-of-court restructuring will cause corporate debtors to switch quicker, and more often from out-of-court restructuring efforts to composition (in-court) restructuring proceedings.