Briefing November 2020 (Update)

Overview of Composition and Insolvency Proceedings

Crisis situations require quick and decisive – but nevertheless prudent – actions by the board of directors. The main focus lies on maintaining liquidity (e.g. short-time work, salary negotiations, improving receivables management, deferring investments, termination of non-essential contracts, etc.). In addition, further operational and balance sheet restructuring measures should be assessed. If, despite such measures, an out-of-court restructuring appears no longer possible, the **board** can generally choose between **two insolvency proceedings**. If the company is over-indebted, the board may be **obliged** to initiate such proceedings. The choice of the appropriate proceedings depends primarily on whether the future business development is expected to be "U"-shaped (composition proceedings) or "L"-shaped (bankruptcy proceedings).

1. In case of **composition proceedings**, the company continues its activities under the supervision of an administrator; this can lead either to a successful restructuring or the liquidation of the company. Unlike *e.g.* in US Chapter 11 proceedings, there is a shift of competences from the board of directors to the administrator and, accordingly, the choice of the administrator (usually proposed by the company) is crucial. Since such proceedings entail costs (administrator fees alone range in our experience between CHF 10'000 to CHF 30'000 even in simpler cases), they should in our view only be chosen if there is at a minimum the prospect of a successful restructuring (possibly by selling part of the business; "prepack") or for the confirmation of a composition agreement (*i.e.* at least for part of the business a "U"-shaped development is expected).

2. **Bankruptcy** proceedings result in the liquidation of the company. They should therefore be pursued, if there is no prospect of a successful restructuring or for the confirmation of a composition agreement (*i.e.* expected "L"-shaped business development).

From a shareholders' point of view, bankruptcy leads to a total loss. In composition proceedings there is still a chance to secure a successful restructuring and thus partial preservation of values. This requires, however, that the shareholder makes, or has made, an appropriate contri-

bution to the restructuring (*e.g.* waiver or subordination of claims, granting of new loans, salary waiver if the shareholder is an employee, etc.).

The **COVID-19-specific regulations** in the area of insolvency law established in April 2020 (temporary relief of duty to file for bankruptcy, COVID-19 moratorium, facilitation of composition proceedings) have been repealed as of 20 October 2020 and the ordinary regulations – as explained below – apply again.

Changes per 20 October 2020

Repeal of the COVID-19-specific regulations: The Federal Council decided *not* to prolong the COVID-19-specific regulations established in April 2020 in the area of insolvency law. Therefore, as of 20 October 2020 the relief of the duty to file for bankruptcy despite over-indebtedness – which was granted under certain conditions - is no longer applicable; i.e. the board is again obliged to file for bankruptcy in case of over-indebtedness. However, until March 2022 COVID-19 Loans up CHF 500'000 still do not count as debt when assessing whether a company is over-indebted. Further, the newly introduced insolvency proceedings for SMEs, the so-called COVID-19 Moratorium, has been repealed. Lastly, temporary facilitations regarding composition proceedings have lapsed but in turn the maximum duration of the provisional moratorium has been increased to eight months.

Composition Proceedings

Initiation of Proceedings

Composition proceedings are initiated by a **request** of the company (or a creditor who would be eligible to file a request for bankruptcy) with the court; which must be accompanied by a current balance sheet, a profit & loss statement, a liquidity plan and a preliminary restructuring plan. The company is usually required to make a **deposit payment** for the estimated costs of the proceedings (in particular the administrator's fees).

The court grants a **provisional moratorium** *(provisorische Nachlassstundung)* of up to four months (which can now be prolonged for up to another four months), **except** if there is **clearly no prospect** of a successful restructuring or confirmation of a composition agreement. Usually, the provisional moratorium is **published** and the court appoints an **administrator**. Such publicity can, of course, have a negative effect on business continuation; upon request, the court may therefore abstain from publishing – in which case an administrator must be appointed. The administrator is often proposed by the company itself. He or she must be independent and should have relevant experience; often lawyers or fiduciary service providers are appointed. Due to the key role of the administrator in the composition proceedings (and related costs), the selection process should favour a person with a pragmatic and managerial approach.

Phase I – Composition Moratorium (Nachlassstundung)

The provisional (and later the definitive) composition moratorium has in particular the following **effects**:

– debt enforcement proceedings cannot be initiated nor continued (particularly no opening of bankruptcy);

– except for urgent cases, court and administrative proceedings regarding stayed claims are paused;

– with the consent of the administrator, the company may terminate long-term contracts (*Dauerschuldverhältnisse*) if otherwise the goal of the restructuring cannot be achieved;

– the court may impose that certain acts can only be performed with approval of the administrator or that the administrator is generally in charge of the company's management;

– sale or encumbrance of non-current assets (*Anlagevermögen*) or granting of security are only possible with the consent of the court or the creditors' committee;

– acts performed during the moratorium with the consent of the court or the creditors' committee cannot be challenged under fraudulent conveyance laws.

Upon granting of the provisional moratorium, the administrator draws up an **inventory**, issues a **creditor call**, assesses the restructuring prospects and informs the court of its conclusion thereon.

If there are **prospects** for a **successful restructuring** or for **confirmation of a composition agreement** (*i.e.* approval by creditor quorum and court; see below), the court grants a **definitive** moratorium (*definitive Nachlassstundung*) for a further four-six months (extendable to 12-24 months). Otherwise, bankruptcy is opened. The definitive moratorium is published and an administrator re-appointed (both mandatory).

If at any time during the moratorium there is clearly no longer any prospect of a successful restructuring or confirmation of a composition agreement, bankruptcy is opened.

Phase II – Outcome / Composition Agreement (*Nachlassvertrag*)

The outcome of composition proceedings is open-ended and may lead to the following results:

– **successful restructuring before the lapse of the moratorium**, which is lifted as a consequence;

– confirmation of an **ordinary composition agreement** (*ordentlicher Nachlassvertrag*): Creditors partially waive and/or stay their claims. The company remains in existence and continues in business;

– confirmation of a **composition agreement with assignment of assets** (*Nachlassvertrag mit Vermögensabtretung*): The company is liquidated in a "milder" form of bankruptcy. The composition agreement sets out how the liquidation takes place.

– **bankruptcy.**

Unless a successful reorganization is already achieved during the moratorium, the administrator drafts a **composition agreement** and submits it to the creditors and the court. The composition agreement requires the following consent of **third class creditors** (privileged claims and secured claims in the amount of the estimated value of the collateral are not counted):

– majority of the creditors who represent at least two thirds of the claims amount, or

– a quarter of the creditors who represent at least three quarters of the claims amount.

A composition agreement approved like this further requires approval by the **court**, which is only granted if:

– the undertakings of the company are adequate;

– privileged claims and claims that have arisen during the moratorium with consent of the administrator are fully paid; and

– in case of an ordinary composition agreement, the shareholders of the company make an adequate contribution to the restructuring.

If the composition agreement is rejected by the creditors, bankruptcy is opened over the company. The court may still amend an insufficient composition agreement which was accepted by the creditors.

Sale of a part of the business ("prepack")

If there are specific intentions to sell part of the business as part of the restructuring measures, it can be expedient to initiate composition proceedings. As a sale during composition proceedings with consent of the court or the creditors' committee cannot be challenged under fraudulent conveyance laws (whereas there is no certainty that consent is obtained), the risk of such challenge and personal liability of board members in this regard (allegation of a sales price set too low) can be largely eliminated.

Bankruptcy

The court will open bankruptcy over the company upon a respective request of the **board** due to over-indebtedness. In addition, the company may file for bankruptcy itself if it is insolvent (even if not over-indebted). Bankruptcy can also be requested by a **creditor** if its undisputed or court awarded claims are not discharged despite debt enforcement proceedings or if the company generally stops its payments due to illiquidity.

The bankruptcy office normally shuts down business operations with immediate effect and administers the bankruptcy estate going forward. The claims filed upon a creditor call are either admitted in one of the three bankruptcy classes or rejected. The assets are realised and the net proceeds distributed to the creditors according to their class.

Bankruptcy may be opened over the Swiss branch of a foreign company, even if no bankruptcy has been opened over the latter. If the foreign company is declared bankrupt, an auxiliary bankruptcy can be conducted for the Swiss branch upon recognition of the foreign bankruptcy decree.

Mandatory filing for bankruptcy

If the board of directors has founded concerns that the company is over-indebted (liabilities are no longer covered by assets; *Überschuldung*), it must prepare **interim balance sheets** at going concern and liquidation values and have them audited by an approved auditor. If both balance sheets show an over-indebtedness, the board must file for bankruptcy with the court (balance sheet deposition; CO 725 II). Until March 2022, state-guaranteed **COVID-19 loans** of up to CHF 500'000 will not be counted as debt for purposes of assessing whether a company is over-indebted within the meaning of CO 725 II.

If a continuation of the business activities during the next 12 months is likely not to be possible (no **going concern**; in particular due to lack of liquidity), financial accounting must switch to – usually substantially lower – liquidation values (CO 958a II); and the board must file for bankruptcy if the interim balance sheet applying liquidation values shows an over-indebtedness. Therefore, illiquidity often leads to over-indebtedness, which in turn triggers the duty of the board to file for bankruptcy.

No filing for bankruptcy is required, if creditors subordinate claims at a level sufficient to cover the over-indebtedness or if the company files for composition proceedings. Furthermore, a **short delay** in filing for bankruptcy (max. four-six weeks) is admissible, if the board immediately implements specific restructuring measures and there is a realistic prospect for a long-term financial recovery of the company. If the board does not file for bankruptcy despite obvious over-indebtedness, the **auditor** is obliged to make the bankruptcy filing instead.

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