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SWISS INSOLVENCY LAW UPDATE

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"the new law emphasizes the importance of illiquidity leading to bankruptcy"

This article provides a brief overview of important recent developments in Swiss insolvency legislation and case law. The first part of this article focuses on upcoming changes in the law with respect to out-of court restructurings, bankruptcies triggered by public claims as well as measures against abusive bankruptcies. The second part of the article sheds some light on new Swiss case law pertaining pre-packs.

Revision of corporation law reorganization provisions

The Swiss Code of Obligations (CO) includes the Swiss corporation law and has so far provided for certain out-of-court restructuring measures regarding financially distressed debtors.[1] On January 1, 2023, the amended CO (Art. 725 to 725c revCO) will come into force in Switzerland.[2] The objective of the revised law is to (a) clarify the current law and codify existing practice and case law, (b) create new incentives for early restructuring and (c) expand the board of directors' scope of action while at the same time specifying its obligations.

Simultaneously, the Swiss Federal Code on Debt Enforcement and Bankruptcy (DEBA)[3] will be partially amended with regard to the opening of bankruptcy proceedings (Art. 173a para. 2 revDEBA), avoidance claims (Art. 285 para. 4 revDEBA), the debt restructuring moratorium (Art. 293a para. 2, Art. 295 para. 4 revDEBA) and the composition agreement (Art. 319 para. 1, Art. 334 para. 4 revDEBA).

While the amended law brings no fundamental changes compared to the existing law, it clearly stresses the importance of the company's liquidity. In addition to the currently prevailing balance sheet-related components of bankruptcy (capital loss and over-indebtedness), the new law emphasizes the importance of illiquidity leading to bankruptcy. In general, the directors of Swiss enterprises have enhanced duties and there is more legal uncertainty which will cause a higher liability risk for them.

I. Imminent payment incapacity

Although not specifically stipulated, already under Art. 716a para. 1 sec. 3 CO of the current corporate law, which regulates the general financial responsibility of the board, the directors have a duty to monitor the company's payment capacity and conduct liquidity planning. However, the new Art. 725 revCO explicitly requires the board of directors to monitor solvency and imposes mandatory steps to be taken by the board in the event of impending insolvency. Hence, the mere risk of becoming unable to pay liabilities as they fall due will become a trigger that requires the directors to take certain actions. If the proposed actions are to be resolved by the general meeting of the shareholders, the board has to convene such meeting or file for a debt restructuring moratorium if necessary. However, unlike the Swiss Federal Council's proposal draft, the Swiss legislator did not introduce an obligation to draw up a liquidity plan in the event of impending insolvency. These new rules apply even prior to the provisions on capital loss and overindebtedness.

II. Capital loss

In the event of a capital loss (i.e. if the latest annual balance sheet shows that half of the share capital and the legal reserves are no longer covered by assets), the revised law (Art. 725a revCO) allows the board of directors more flexibility for action and abolishes the current obligation to convene a general meeting in the event of a capital loss of the company. If the company does not have a statutory auditor (so called opting out), a licensed auditor must be appointed unless the board petitions a composition moratorium (Art. 725a para. 2 and 3 revCO).

III. Overindebtedness

The revised law (Art. 725b revCO) provides more clarity in the event of justified concern regarding overindebtedness of the company (i.e. if the interim balance sheet shows that the claims of the creditors are no longer covered by its assets appraised at going concern and liquidation values). The current option of not notifying the insolvency court if creditors accept the subordination of their claims remains in force but a valid subordination must also include interest accruing on the subordinated claims. Furthermore, the current practice – that is that of not having to file for bankruptcy if there is a reasonable prospect that the overindebtedness can be remedied within a reasonable period (so called reorganization under corporation law) – will now be explicitly stated in the law whereby the said period is limited to a maximum of 90 days after the audited interim financial statements are available and provided that claims of the creditors are not additionally jeopardised by the deferral of the judge notification. Legal uncertainty remains as to how long the reorganisation horizon within the 90 days is

1 Article 725 and 725a CO (in conjunction with Article 820 CO).
2 https://www.fedlex.admin.ch/eli/oc/2020/746/de (p. 4041 et seqq.).
3 https://www.fedlex.admin.ch/eli/oc/2020/746/de (p. 4067 et seqq.).

appropriate and how the additional exposure of creditors' claims is assessed.

Availability of bankruptcy proceedings for claims based on public law

Art. 43 sec. 1 and 1bis DEBA of the current law provide that bankruptcy enforcement is excluded for claims under public law such as taxes or premiums for mandatory accident insurance. This means that debtors who are otherwise subject to bankruptcy enforcement are currently subject to seizure of property proceedings for claims based on public law. However, in March 2022, the Swiss Parliament decided to revise Art. 43 DEBA and abolish these exceptions to bankruptcy proceedings.[4]

This will be a fundamental change of concept. Since the public sector as a whole is the most frequent creditor category in Switzerland, the change in the law will have far-reaching effects in practice.

The referendum period regarding this law amendment runs until 07 July 2022 but it is highly unlikely that by this date the Swiss voters will collect signatures to challenge this law. On the other hand, the date of entry into force is currently unknown. However, it seems rather unlikely that the amendment will come into effect at the beginning of 2023 already.

Measures against abusive bankruptcies

In March 2022, the Swiss Parliament adopted the provisions on combating abusive bankruptcy.[5] The package includes, among others, amendments to the CO and the DEBA.

In the CO, in particular so-called trades in shares of shell companies ("Mantelhandel") will be prohibited. If a company no longer has any business activities and realizable assets and is overindebted, the transfer of shares will be void (Art. 684a revCO). In addition, the waiver of the limited audit (so-called opting out) will be restricted in the future (Art. 727a revCO).

In the DEBA, two provisions will be amended. Art. 11 revDEBA stipulates bankruptcy officials' duty to report criminal installments and Art. 222a revDEBA foresees the delivery and opening of mail by the bankruptcy office. In addition, in Art. 230 revDEBA the deadline to request the execution of bankruptcy proceedings after the cessation of bankruptcy proceedings is extended from ten to 20 days.

The referendum period runs until 07 July 2022, and the date of entry into force is not yet known. However, entry into force at the beginning of 2023 seems rather unlikely.

Swiss pre-packs

While "pre-packs" are generally a well-established and effective restructuring measure in common law jurisdictions, they are a relatively new and stil rare phenomenon in Switzerland but one that is increasingly gaining importance in practice.

In the absence of an explicit legal basis, in a decision of 2020, a district court in the Canton of Zurich[6] approved the transfer of business units of a debtor in a so-called pre-pack transaction simultaneously with the grant of a provisional debt restructuring moratorium despite the fact that no administrator was appointed. The said judgement set out clearly the relevant requirements and provided helpful guidelines for future transactions.

In a more recent «leading case» on Swiss pre-pack restructurings, the Swiss Federal Supreme Court[7] has confirmed the previous legal practice of privately pre-negotiated, confidential pre-pack restructurings in Switzerland and thus provided legal certainty under Swiss law in particular regarding (i) the general admissibility of pre-packs, (ii) the approval of pre-packs by the competent composition court without a hearing of the creditors, and (iii) the (largely excluded) rights to appeal by creditors which provides sustantial deal security for potential buyers since the court-authorized transaction is protected against claw-back and avoidance claims. Such approval may generally be granted if the sale is, based on the court's reasonable discretion, to the creditors' advantage in comparison with bankruptcy proceedings and an urgent sale is of essence for the success of a restructuring.

Hence, a swift restructuring by way of a pre-negotiated sale of certain assets or an entire business during a (silent) composition moratorium is not only possible under Swiss law but may minimize the loss of value and negative publicity which is normally associated with public bankruptcy proceedings in Switzerland.

4 https://www.parlament.ch/centers/eparl/curia/2019/20190043/Schlussabstimmungstext%201%20SN%20D.pdf (p. 3).
5 https://www.parlament.ch/centers/eparl/curia/2019/20190043/Schlussabstimmungstext%201%20SN%20D.pdf.
6 Bzger Bülach, EC200010-C/Z1.
7 BGer 5A_827/2019.

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