BAKER & MCKENZIE

Switzerland

Overview and Introduction

A number of Swiss laws contain rules applicable to the restructuring and insolvency of companies, ranging from corporate directors' duties to formal bankruptcy proceedings. In particular, for the two most popular corporate forms offered by Swiss law, namely the corporation (*Aktiengesellschaft, AG*) and the limited liability company (*Gesellschaft mit beschränkter Haftung, GmbH*), the Swiss Code of Obligations ("**CO**") contains various rules regarding private restructuring measures involving creditors or owners, i.e. the shareholders of a corporation or the quotaholders of a limited liability company. The formal, mainly administrative and court-based, insolvency and bankruptcy procedure is regulated in the Swiss Debt Enforcement and Bankruptcy Act (the "**Bankruptcy Act**"). The Bankruptcy Act mainly regulates debt enforcement (regarding claims in money) and insolvency procedures against private individuals and legal entities, and sets out the procedure for enforcing collaterals. It further contains rules for composition procedures and agreements. Special rules apply to the financial sector with bankruptcy rules contained in the relevant Swiss banking acts. Insolvency and bankruptcy involving cross-border issues are dealt with in the Swiss Federal Act on Private International Law. Finally, criminal law provisions deal with criminal acts such as fraudulent bankruptcy or the disposition of seized assets.

Restructuring and Liquidation

Liquidation or Restructuring?

Solvent Liquidation

A Swiss company can be liquidated at any time by a qualified resolution of its owners. For corporations, this requires at least two-thirds of all shares represented at the shareholders' meeting which in addition represent more than 50% of the nominal value of the represented shares. For limited liability companies, such a resolution requires the approval of at least two-thirds of the votes represented at the quotaholders' meeting and an absolute majority of the entire nominal capital in respect of which a right to vote may be exercised. If the qualified resolution passes, a liquidator is appointed to prepare the final balance sheet, call for the filing of claims and distribute the net assets before the company is dissolved and cancelled in the commercial register.

If the company is to be dissolved without liquidation by means of a merger (or demerger), the approval of the aforementioned qualified majority likewise is required. If one of the companies is over-indebted or has a loss of capital, the other company must have freely distributable equity in the relevant amount.

Compulsory Liquidation

A company is liquidated as a consequence of bankruptcy proceedings. Bankruptcy proceedings are initiated either by creditors or by the company itself upon the determination of over-indebtedness. Furthermore, certain forms of composition proceedings can lead to the liquidation of the companies, as explained below.

Financial Restructuring

Insolvency does not necessarily lead to the liquidation of the company: the company and its creditors may find ways to restructure the company. Restructuring may be achieved by means of internal business measures, private arrangements with creditors or recapitalisation through investors, or alternatively by means of a composition procedure involving the appointment of a commissioner, as well as court approval.

Duties of the Directors

In General

The directors of the company (i.e. the board of directors of a corporation and the managing directors of a limited liability company) are charged with the overall management of the company. As such, the directors are obliged to supervise the financial situation of the company, i.e. to implement an adequate system for accounting, financial planning and control, and to take all measures necessary to ensure the company's liquidity and financial stability as required by the specific financial situation of the company. The directors may become personally liable for violations of their duties.

Early Intervention

If the directors establish early enough that the company may encounter financial difficulties, the restructuring process may be limited to business decisions such as measures to increase business profitability, or corporate restructurings and accounting measures. The management may decide to raise capital from investors or negotiate private arrangements with creditors.

In case of loss of capital – i.e. if the balance sheet shows that half of the nominal capital and the statutory reserves are no longer covered by the assets – the directors are obliged to propose reorganisation measures to the company's general assembly.

Over-Indebtedness and Bankruptcy Proceedings

The balance sheet may show that the claims of the company's creditors are no longer covered, i.e. that the company is over-indebted. If this is the case, based on going-concern as well as on liquidation values, the directors are obliged to notify the court. According to case law, however, such notification need not be made where there is a substantiated likelihood for restructuring within a period of four to six weeks, or in case certain creditors subordinate their claims. Under these circumstances, the directors may then negotiate private restructuring measures with creditors.

If these conditions are not met, however, the court will open bankruptcy proceedings following the directors' notification. The judge may grant a postponement of bankruptcy proceedings upon specific application by the directors under the condition that there are substantiated chances for restructuring. During the postponement period, the company's management may then negotiate private restructuring measures with creditors. If needed, the judge may appoint a commissioner for the time of the postponement, although in practice this measure is rarely used.

Alternative Solution: Composition Proceedings

The company may also apply for composition proceedings. In such cases, the court may rule for a moratorium of up to two years. During such time the company may, under the supervision of a commissioner, negotiate restructuring measures with its creditors. Subject to court approval, such a composition agreement is binding for all creditors. However, if the court concludes that there is obviously no chance for a successful restructuring, it will open formal bankruptcy proceedings according to the Bankruptcy Act, which will lead to the liquidation of all assets and receivables and the dissolution of the company.

Private Reorganisation and Restructuring

Apart from normal business measures, Swiss commercial and corporate law offers a wide range of instruments to address liquidity problems. These include recapitalisation measures involving investors and creditors. An overview of available mechanisms (highlighting the limits of such options) is given below.

Recapitalisation by Owners

Reduction of Nominal Capital: A normal reduction of nominal capital (i.e. for corporations the share capital and for limited liability companies the nominal capital) only serves to adjust the nominal capital amount to the actual amount of equity. Thus, financial restructuring is only achieved if a reduction of nominal capital is combined with a capital increase or capital contribution.

Capital Increase: A capital increase generally only leads to a solid financial restructuring of the company if it is funded in cash (as opposed to a contribution in kind). The existing owners' pre-emptive rights regarding the newly issued participations (i.e. for a corporation, the shares, and for a limited liability company, the quota) may be withdrawn for the benefit of a new investor.

Changes to the nominal capital generally require the approval of a simple majority of owners. For corporations, a qualified majority of at least two-thirds of all shares represented at the shareholders' meeting which in addition represent more than 50% of the nominal value of the represented shares is, however, necessary if the pre-emptive rights of shareholders are withdrawn or the capital increase is funded by contributions in kind or made to fund acquisitions in kind. For limited liability companies, all increases of nominal capital require the approval of at least two-thirds of the votes represented at the quotaholders' meeting and an absolute majority of the entire nominal capital in respect of which a right to vote may be exercised. The by-laws of the company can require higher percentages.

Recapitalisation by Financial Creditors

Financial creditors may be motivated to approve private restructuring arrangements if they assess that in a successful private restructuring their loss would be smaller than in composition or bankruptcy proceedings. Thus, companies often issue a plan outlining proposed restructuring measures for approval by all financial creditors. For the duration of such measures, the company and its financial creditors often also enter into a standstill arrangement. Restructuring solutions may include the following.

Bridge Loans

Bridge loans provide liquidity to the company to continue business operations during restructuring periods and are often crucial to the company's survival. There is, however, uncertainty as to the legality of a repayment of such loans immediately prior to the opening of bankruptcy proceedings. More specifically, there is a risk that once the company has entered bankruptcy proceedings, actions may be brought by other creditors or the bankruptcy administration to declare such repayment void due to the disadvantage incurred by other creditors (*actiones paulianae*). In order to ensure the full and lawful repayment of a bridge loan prior to the opening of bankruptcy proceedings, bridge loans are generally secured and the company must ensure that all proceeds of the loan are used solely to pay off the company's accounts payable, but not financial indebtedness.

Subordination of Claims

Creditors may subordinate their claims in such a way that they shall be payable (in full or in part) only once all other creditors have been fully repaid. Although such arrangements do not alter a state of over-indebtedness, this measure will allow the directors to avoid a court filing for bankruptcy.

Debt-equity Swaps

In order to decrease debt, a company may move for a capital increase where the participations are paid in by way of setting off creditors' claims. There is a doctrinal controversy regarding the extent to which such debt may be regarded as a valid contribution to the nominal capital. While one view holds that the full nominal value of the debt may be considered as a valid contribution to the nominal capital, the other view suggests that only the market value of such debt may be set off against the claim to pay in the nominal capital. In the absence of clear case law, the risk remains that an additional contribution equal to the difference between the nominal value and the market value of the debt has to be made.

In cases involving a corporation, debt-equity swaps may be agreed with lenders in advance. In this case, the corporation will, at the time of entering into the loan agreement, issue conditional share capital. This conditional share capital is automatically triggered at the time specified, at which point the loan repayment sum is set off against the amount to be paid in for the shares. As Swiss law does not provide a mechanism to issue conditional nominal capital for limited liability companies, any debt-equity swaps involving limited liability companies can only be effected through a regular increase of the nominal capital.

Debt-asset Swaps

A company may also swap debt for assets. While market sales of assets to obtain liquidity may prove to be difficult or involve high transaction costs, creditors may be willing to purchase assets on preferential terms. Since such transactions provide advantages to the respective creditors, they may be declared void by the court upon an action filed by creditors or the bankruptcy administration once bankruptcy proceedings are initiated.

Waiver of Claims

As a last resort, creditors may agree to a full or partial waiver of their claims in order to prevent the company's bankruptcy.

Characteristics of Private Restructuring Measures

In general, private restructuring measures do not involve administrative or court proceedings. As set out above, the measures require the approval of the company's financial creditors or its owners. If unsuccessful, however, private restructuring measures will be followed by formal bankruptcy or composition proceedings. While these measures may be helpful in providing financial stability, some bear the risk of being deemed void, or even of civil or criminal liability both for the company and its managers.

Formal Bankruptcy Proceedings

Initiation of Bankruptcy Proceedings

As set out above, a company may file for its own bankruptcy. This applies to legal entities upon determination of insolvency or over-indebtedness, if the directors do not succeed in negotiating private restructuring measures or composition agreements.

Bankruptcy proceedings may also be initiated by a creditor. A creditor may file an enforcement request with the competent debt enforcement office regarding a claim against the company. If the claim is not paid or successfully contested in court, the competent bankruptcy court will (after a warning) open bankruptcy proceedings against the company. The court must notify the bankruptcy office as well as the commercial and land registers.

Effects of Bankruptcy Proceedings

Effects on the debtor's assets: All seizable assets and receivables owned by the debtor at the time of the opening of the bankruptcy proceedings form the bankrupt estate. Actions for adherence may be filed to include disputed assets or receivables of the debtor. The debtor loses the capacity to dispose of the assets in the bankrupt estate. The bankrupt estate is deemed a legal entity whose rights are represented by the bankruptcy administrator. All other enforcement proceedings against the debtor cease, and new proceedings may only be initiated against the bankrupt estate.

Effects of the bankruptcy on creditors' rights: All obligations of the debtor become due against the bankrupt estate, and all claims whose object is not a sum of money are converted into monetary claims of corresponding value. The bankruptcy office draws up an inventory of the bankrupt estate and informs the creditors of the company by way of public announcements. Depending on the size and the complexity of the estate, the bankruptcy administrator may decide to proceed with ordinary or summary proceedings, or to discontinue proceedings where there is a lack of funds. The bankruptcy proceedings are coordinated by the bankruptcy administration, which is provided for by the cantonal authorities. At the first meeting of all creditors, however, the cantonal authorities' representatives may be replaced by a private bankruptcy administration and a supervisory creditors' committee.

Maintenance and Clarification of the Bankrupt Estate

Civil court proceedings can be initiated to determine the scope of the bankrupt estate, for example if third parties claim ownership or other prevailing rights regarding inventoried assets. Conversely, the bankruptcy administration may claim that certain assets of third parties should be included in the estate.

Furthermore, the bankruptcy administration can commence proceedings against third parties to declare void certain transactions that were made prior to the opening of bankruptcy proceedings – for example, if they were preferential to certain creditors to the detriment of others.

Claims of the bankrupt estate can lead to lengthy (and possibly unsuccessful) court procedures. Therefore, the bankruptcy administration and the creditors may assign contested claims to certain creditors willing to take the risk of enforcing those claims. The proceeds that the respective assignees gain from their efforts will be used to cover their personal claims, whilst any surplus is handed over to the bankrupt estate.

Realisation and Distribution of the Estate, and Dissolution of the Company

Once the content of the estate is clarified, all assets are realised by way of public auction, unless the creditors, in a second meeting, decide to sell assets privately. Costs and expenses of the proceedings are paid beforehand. These include any agreements the company entered into or prolonged after the opening of bankruptcy proceedings, such as rental agreements for offices or storage facilities, as well as the costs of employees who continued to work after the opening of bankruptcy proceedings.

Secured claims are satisfied with the proceeds from the respective collateral. The remainder belongs to the bankrupt estate. All unsecured claims are satisfied according to their rank. Claims of employees as well as certain claims of insured persons are prioritised. All other unsecured claims are satisfied subsequently.

Upon the distribution of all proceeds and the final court approval of the closure of the bankruptcy proceedings, the company is dissolved and consequentially cancelled in the commercial register.

Composition Proceedings and Agreements

Initiation of Proceedings and Effects of the Moratorium

Composition proceedings are primarily aimed at the financial restructuring of the company, but in certain forms also lead to the dissolution of the company. The balance between restructuring the company and satisfying its creditors is reflected in the composition agreement. Unlike in bankruptcy proceedings, the main decisions regarding the procedure and outcome of the restructuring are taken not by administrative authorities or courts, but by the creditors, based on negotiations with the debtor.

Composition proceedings may be initiated by the debtor itself, by certain creditors or by the bankruptcy court. The composition proceedings begin with a provisional moratorium as a first instrument of creditor protection. The total duration of the provisional moratorium may, in any case, not exceed four months. Though the provisional moratorium is not granted automatically, but only by court decision, new provisions have been introduced recently to facilitate and accelerate the approval of provisional moratoriums. Further, the composition courts may adapt the terms of the provisional moratorium to the particularities of each case, for example by abstaining from appointing a provisional commissioner or from publishing the approval of the provisional moratorium. After determining that there are prospects for recovery, the court will set a fixed moratorium for a period of four to six months (which can be extended in complex cases up to a maximum period of two years) to allow for the negotiation of the composition agreement. The court also appoints a commissioner to supervise the business during the fixed moratorium period.

During the moratorium period, enforcement proceedings against the debtor may neither be continued nor initiated. Also, any interest on claims that are not secured by collateral ceases to accrue against the debtor. The debtor may continue its business under the supervision of the commissioner. The court may decide on the extent of the commissioner’s involvement. By law, however, certain transactions require approval by the composition court or, if appointed, the creditor committee.

Neither a provisional moratorium nor a fixed moratorium necessarily results in a composition agreement or bankruptcy proceedings. Should the private financial restructuring measures succeed without a formal composition agreement being necessary, for example through an arrangement between the debtor and its (main) creditors or through other financial restructuring measures, the moratorium may be lifted by the composition court without further measures.

Content of the Composition Agreement

Upon his appointment, the commissioner draws up an inventory of the debtor's assets, publishes an announcement to all creditors to file their claims and drafts the composition agreement which is then negotiated with the creditors. As soon as a draft composition agreement is prepared, the commissioner convokes a meeting of the creditors. At the meeting, the commissioner informs about the financial situation of the debtor and submits the draft composition agreement to the creditors for approval by signature. A composition agreement determines to what extent the creditors waive their claims, and when and how the debtor fulfils its (remaining) obligations. The Bankruptcy Act provides for different types of composition agreements. In practice, however, a composition agreement usually combines the aspects listed below to the extent required by the specific situation.

Composition Agreement with Extension of Payment Terms: Such agreements contain provisions to extend the payment terms of the outstanding claims. In such cases, the debtor agrees to pay all claims in full, based upon an adjusted time schedule.

Composition Agreement with Partial Waiver: The creditors may agree to a partial waiver of their claims.

Composition Agreement with Assignment of Assets: A composition agreement may provide for all or part of the debtor's assets to be assigned to the creditors or a third party. Since this type of composition agreement leads to the dissolution of the company, the applicable proceedings are similar to bankruptcy proceedings.

Creditors' Approval, Court Confirmation and Effects

The composition agreement generally requires the consent of a qualified majority of the creditors. Once approved by the creditors, the commissioner files the agreement with the composition court for final approval upon which the composition agreement becomes binding for all creditors. However, in case of composition agreements with extension of payment terms or with partial waiver, the agreements may be approved by the court and thus, be declared applicable to all creditors of the debtor, only if the owners of the debtor have made an adequate contribution to the financial restructuring of the debtor in addition to and apart from the contribution of the creditors. With the court's approval, the enforcement proceedings initiated against the debtor prior to the moratorium and stayed during the moratorium are terminated (with the exception of enforcement proceedings against collateral).

In case of financial institutions that are relevant to the Swiss economy or the Swiss financial system as a whole, the Swiss Financial Market Supervisory Authority ("**FINMA**") may approve the composition agreement even without the creditors' consent. FINMA's approval is subject to the condition that the agreement represents a reasonable solution regarding both the satisfaction of the creditors and the restructuring of the debtor.

If the composition agreement provides for assets to be assigned, the debtor loses the capacity to dispose of such assets at the time of confirmation of the agreement. The sale of such assets may be organised as the liquidator and the creditor committee see fit. If all assets are assigned and the company thus liquidated, the company is cancelled in the commercial register.

Baker & McKenzie Zurich
Holbeinstrasse 30
Zurich 8034
Switzerland

T +41 44 384 14 14
F +41 44 384 12 84

Baker & McKenzie Geneva
Rue Pedro-Meylan 5
Geneva 1208
Switzerland

T +41 22 707 9800
F +41 22 707 9801