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Insolvency 2021

Switzerland: Trends & Developments

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Trends and Developments

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Pre-Packs: New Leading Case Confirms Admissibility and Advantages

Introduction

Pre-packs are a relatively new phenomenon in Switzerland. Until 2014, transactions that were approved by a competent court in insolvency proceedings could still be challenged in a claw-back action by creditors of the failed company. Hence, the legal risks involved in the sale of assets of an insolvent company were considerable, irrespective of whether such sale was completed prior to the opening of insolvency proceedings or after the opening of such proceedings. Only with the exclusion of an appeal against a pre-pack transaction approved by a competent court in insolvency proceedings in the new Article 285 paragraph 3 of the Swiss debt enforcement and bankruptcy act (DEBA) in the beginning of 2014, pre-packs slowly gained importance and spread in doctrine and practice in Switzerland.

A recent Federal Supreme Court decision, which largely confirmed the advantages of a pre-pack as postulated in the doctrine and thus once again significantly increased legal certainty, is likely to further accelerate the spread of this restructuring instrument and contribute to its popularity and importance in Switzerland.

Principles

A pre-pack is generally understood to be a restructuring concept in which a debtor close to insolvency prepares the sale of its business or parts thereof before the commencement of composition proceedings in order to have the sale approved by the competent court after the granting of the composition moratorium and thus to exclude the risk of the sale being contested by dissatisfied creditors of the insolvent company on the basis of claw-back claims (Article 285 paragraph 3 of the DEBA).

Advantages of a pre-pack

The advantages of a pre-pack are manifold.

- Individual viable parts of the business can be separated from the rest of the business and transferred to a pre-pack solution (eg, rescue company). Buyer and seller are largely free – subject to the approval of the competent court – to determine the assets, contracts and liabilities to be transferred ("cherry-picking").
- Article 333b of the Swiss Code of Obligations (CO) allows for the selective assignment of employment relationships and grants the transferee an exclusion of liability for employee claims arisen prior to the transfer.
- Negotiations can be conducted confidentially without the need to inform creditors or other third parties. Even the moratorium can be applied for as a "silent" moratorium, which means that the pre-pack solution can be kept secret until it is executed. In many situations, the threatened loss of value due to the announcement of a "distressed sale" can be prevented in this way.
- Creditors and the court have no say or control rights in the negotiation phase. However, creditor interests must be taken into account insofar as the competent court will only approve pre-pack solutions that take the best possible account of creditor interests.

Once the competent court has approved the pre-pack solution, a challenge by dissatisfied creditors is practically impossible (Article

285 paragraph 3 of the DEBA). A challenge is excluded in particular based on the argument that the price achieved was too low or that creditor interests were not duly taken into account in some other way.

The flexibility and confidentiality of pre-pack solutions are important advantages for the debtor but can at the same time represent weighty disadvantages from the creditor's point of view. Creditors may see themselves as disadvantaged in particular if they themselves would have had an interest in certain of the debtor's assets or if they believe that the sale price was too low. It is the task of the competent court to take these concerns into account when reviewing the pre-pack and, if necessary, to refuse approval if better solutions would have been possible for the creditors.

Risks

Although creditors do not have any procedural rights either in the preparation of a pre-pack or in the approval procedure, the debtor and the purchaser are well advised to take into account possible creditor concerns when drafting the pre-pack and to ensure that they can present the merits of the pre-pack to the competent court in a comprehensible and robust manner as the best possible solution.

From the debtor's point of view, pre-pack solutions entail not only advantages but also certain risks, as the filing of the petition for a moratorium (and approval of the pre-pack) largely transfers control over the further steps to the competent court (and partly to the administrator). While the debtor can take certain measures to increase the likelihood of the moratorium being granted and the pre-pack being approved, it is not possible to obtain certainty in advance that the competent court will grant the (provisional) moratorium and approve the pre-pack. In the worst case, the court could even open bankruptcy proceedings right away if it believes that the pre-pack is not the best solution for the creditors and that there is no other viable option for a successful restructuring of the debtor.

Implementation

Pre-packs are not regulated by law, but in Switzerland they are undoubtedly permissible in principle. Typically, pre-packs are structured as a so-called "transferring restructuring", ie, as a transfer of a business or part of a business to a new legal entity (often an existing or newly established rescue company). However, so-called "continuing restructurings" are also possible, eg, if fixed assets are to be sold to alleviate an acute liquidity crisis in order to enable the company in need of restructuring (if necessary, together with other measures) to continue operations.

In preparing a pre-pack, regular discussions with a wide range of parties will be necessary. These include not only potential purchasers of parts of the business or assets, but also important contractual partners (landlords, major suppliers, etc), (financial) creditors, members of the management and employees who are needed for the restructuring concept, possibly the shareholders, etc.

Agreements and contracts

In order to prevent a loss of value due to a planned composition procedure becoming known, the debtor should ensure that the confidentiality of the planned measures is maintained as far as possible when preparing a pre-pack. Confidentiality agreements and strict adherence to the need-to-know principle, for example, serve this purpose.

In view of the fact that the competent court will only approve a pre-pack if no better alternative for the debtor's creditors is foreseeable, particular attention should be paid to the price of the

business or assets to be sold. In this respect, it may be helpful to conduct an auction procedure or to obtain valuation reports (eg, from a financial or M&A advisor involved). Particular attention must be paid to this aspect if the transferee is particularly close to the debtor.

The contract negotiated in the context of a pre-pack for the takeover of certain parts of the business or assets is regularly subject to the condition that the competent court approves the provisional moratorium for the debtor (if necessary for the restructuring as a "silent" moratorium) and consents to the conclusion of the intended legal transactions. Apart from these obvious conditions, the contractual pre-pack arrangements should be drafted as unconditionally as possible, as otherwise a court might be inclined to consider other restructuring solutions and refuse to approve the pre-pack due to the uncertainties regarding the fulfilment of the conditions and the execution of the pre-pack.

In addition to the conditions mentioned above, contracts in pre-pack situations often provide that the contract will lapse if the moratorium and pre-pack are not approved by the competent court by a certain date (long stop date). Such clauses are easily permissible and should be drafted in such a way that, on the one hand, the administrator and the competent court have sufficient time to assess and, if necessary, approve the pre-pack after the application for moratorium has been filed, but, on the other hand, there is not enough time to address alternative solutions during the effectiveness of the moratorium.

Provisional debt-restructuring moratorium and court approval

After signing the legal transactions conditionally concluded as part of the pre-pack, the debtor submits the application for provisional debt-restructuring moratorium. If necessary for the success of the pre-pack, the debtor will apply to waive publication of the moratorium. In this case, a provisional administrator must be appointed.

The debtor can themselves propose a possible provisional administrator in the application for provisional debt-restructuring moratorium. Likewise, it is possible and under certain circumstances sensible to discuss the pre-pack concept with the potential administrator, at least in outline, before filing the request for moratorium, in order to ensure that the administrator has no fundamental objections to the procedure or the envisaged measures. It must be ensured, however, that the independence of the potential administrator is not compromised.

If the competent court confirms the provisional debt-restructuring moratorium, it will usually appoint a provisional administrator who will review the pre-pack and the entire restructuring concept and submit a recommendation to the court. If appropriate, the court may also schedule a hearing and hear the debtor and other parties (prospective purchaser, creditors, etc) before deciding on the pre-pack.

In exceptional cases - namely in the case of great urgency and "clear circumstances" - the competent court may also decide on the pre-pack without appointing an administrator.

After approval

The approval of the pre-pack by the competent court has the effect that the corresponding legal transactions cannot be challenged by creditors or other third parties (Article 285 paragraph 3 of the DEBA). The fate of the residual business depends on the requests in the petition for moratorium and the specific circumstances. In principle, all available options are possible, ie, cancellation of the debt-restructuring moratorium in case the restructuring was successful, continuation of the debt-restructuring proceedings and conclusion of a debt-restructuring agreement or

opening of bankruptcy proceedings if there is no prospect of restructuring and conclusion of a debt-restructuring agreement.

Outlook

Although the Corona pandemic has not yet led to the large number of insolvencies and restructurings originally expected, it is still generally assumed that in Switzerland more companies than in normal times will run into financial difficulties in the near future because of the pandemic. The change in the law made in 2014 and the more recent case law of the Federal Supreme Court present a possible solution for these companies with the pre-pack, which – depending on the circumstances of the individual case – can ensure the continuation of a business (or part of a business) and at the same time guarantee the highest possible return for the creditors and other stakeholders. Without a doubt, the attractiveness of pre-packs has further increased with the latest developments in Switzerland.

Walder Wyss Ltd has a proven track record in corporate and financial restructuring. The firm manages both national and complex international cases, providing comprehensive legal services for strategic and financial restructuring as well as advice on non-performing business transactions. Walder Wyss advises the interest groups involved with regard to Swiss insolvency and bankruptcy proceedings, and also support foreign borrowers when launching and co-ordinating parallel and ancillary proceedings under Swiss insolvency law. In addition, the firm enforces claims against assets located in Switzerland. The firm's restructuring and insolvency team plays an active role in its clients' affairs. This applies both to out-of-court financial and debt restructuring as well as to court proceedings such as moratoriums under company law, standstill agreements and bankruptcy proceedings.

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