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Insolvency 2023

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Switzerland: Trends and Developments

Thiemo Sturny and Dominik Hohler
Walder Wyss Ltd

SWITZERLAND

Trends and Developments

Contributed by:
Thiemo Sturny and Dominik Hohler
Walder Wyss Ltd

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Authors

Thiemo Sturny is a partner in the transaction team at Walder Wyss and advises domestic and foreign clients in all fields of company law, including national and international M&A transactions, restructurings and questions of corporate governance. He also specialises in credit financing, capital market transactions and supporting start-up's in private equity financing matters. Thiemo Sturny publishes regularly in his fields of expertise and is lecturing in the LLM post-graduate degree programme at the University of Zurich. Thiemo is registered in the Zurich Bar Registry.

Dominik Hohler is a partner in the transaction team at Walder Wyss. He advises national and international companies regarding their restructuring, financing, establishment and expansion projects as well as with regard to reorganisation measures and insolvency, and focuses his practice on domestic and international M&A, private equity and venture capital transactions. Additionally, he advises corporate clients on all matters of corporate and commercial law related to their daily operations. Dominik regularly publishes and lectures in his fields of expertise. Dominik is registered in the Zurich Bar Registry.

Contributed by: Thiemo Sturny and Dominik Hohler, **Walder Wyss Ltd**

Walder Wyss Ltd

Seefeldstrasse 123
8008 Zurich
Switzerland

Tel: +41 58 658 58 58
Fax: +41 58 658 59 59
Email: reception-zh@walderwyss.com
thiemo.sturny@walderwyss.com
dominik.hohler@walderwyss.com
Web: www.walderwyss.com

Swiss Bankruptcies Remain at Historic Highs Following COVID-19

Switzerland has, like many other jurisdictions, seen a significant increase in bankruptcies following the coronavirus pandemic. This comes as no surprise, as the government aid measures during the pandemic meant that many businesses that would have been in financial difficulties earlier were able to survive for some time and it was generally assumed that there would be a certain catch-up effect once the aid measures came to an end.

According to a current forecast, around 10,000 companies are likely to go bankrupt in Switzerland in 2023, a similar number to last year. Compared to the average figures for 2018 and 2019, the years before the pandemic, this represents an increase of almost 25%.

In terms of the sectors affected, the ancillary construction industry has been the most affected by insolvencies in 2023 so far, which is likely to reflect a looming slump in the construction sector. Other heavily affected sectors include wholesale and retail, management consultancy and the hospitality industry, each accounting for more than 10% of reported insolvencies.

Relief, if any, is currently foreseeable in sectors strongly characterised by private consumption, while export-oriented companies in particular are struggling. This largely reflects general economic development in Switzerland, which is also characterised by rising inflation figures and slower economic growth, but by significantly lower inflation peaks and a less pronounced slowdown in economic growth compared to other (nearby) countries.

Pre-packs as a Solution for Viable Parts of Insolvent Companies

The evolving landscape of pre-packs in Swiss law and practice

The recent increase in corporate insolvencies has led to another development that was, however, expected: pre-packs have established themselves in Swiss insolvency practice and are increasingly being used to separate viable parts of insolvent companies and keep them going.

A pre-pack is generally understood to be a restructuring concept in which a debtor close to insolvency prepares the sale of its business, part of its business or parts of its fixed assets as far as possible before the initiation of debt restructuring proceedings in order to have the

sale approved by the composition court after the debt restructuring moratorium has been granted and thus exclude the risk of the sale being contested on the basis of Article 285 paragraph 3 of the Swiss Debt Enforcement and Bankruptcy Act (DEBA).

Pre-packs have only been known in Swiss insolvency practice for a relatively short time. Until the introduction of Article 285 paragraph 3 of DEBA at the beginning of 2014, legal acts approved by the composition court could be contested by means of claw-back claims, which posed a considerable problem for pre-pack transactions under the old law and usually made it impossible to achieve the main objective of a pre-pack, the continuation of viable parts of the business.

Since 2014, pre-packs can no longer be contested and the case law that has been handed down since then – which has largely confirmed the advantages of a pre-pack as postulated in the doctrine and thus significantly increased legal certainty – has led to a rapid spread of this restructuring instrument and contributed to its popularity and importance.

More recent court decisions, which have further confirmed the advantages of pre-packs and in some cases have led to the approval of pre-pack transactions in a very short time (as little as a few days), have meant that pre-packs are now considered as a possible solution for at least parts of the company in practically every situation in which a company finds itself in financial difficulties that could lead to insolvency.

Pros and cons

The advantages of a pre-pack are many and varied.

- *Carve-out of individual assets or business units* – Individual viable parts of the business can be separated from the rest of the business and transferred to a pre-pack solution. Subject to authorisation by the composition court, the buyer and seller are largely free to determine the assets, contracts and liabilities to be transferred.
- *Employment contract transfer* – Article 333b of the Swiss Code of Obligations permits the selective takeover of employment relationships ("cherry picking") and grants the transferee an exclusion of liability for employee claims arising prior to the transfer.
- *Confidentiality* – The negotiations can be conducted confidentially without creditors or other third parties having to be informed. Even the debt restructuring moratorium can be applied for as a "silent" moratorium, which means that the pre-pack solution can be kept secret until it is finalised. In many situations, this can prevent the imminent loss of value due to the announcement of a "fire sale".
- *No creditor or court interference in negotiation phase* – Creditors and the composition court have no say or control rights in the negotiation phase. However, creditors' interests must be taken into account insofar as the composition court will only approve pre-pack solutions that take the best possible account of creditors' interests.

As soon as the composition court has approved the pre-pack solution, a challenge by dissatisfied creditors is practically impossible. A challenge is excluded in particular on the grounds that the price achieved was too low or that the interests of creditors were not duly taken into account in another way. Only in exceptional cases may particularly serious defects in the authorisation decision result in nullity.

The flexibility and confidentiality of pre-pack solutions are advantageous for the debtor, but can also represent significant disadvantages from the creditor's perspective. In particular, creditors may consider themselves to be at a disadvantage if they themselves had an interest in certain assets of the debtor or if they believe that the sale price was too low. It is the task of the composition court to take these concerns into account when reviewing the pre-pack and, if necessary, to refuse authorisation if better solutions would have been possible for all creditors.

To avoid such outcome, the debtor and purchaser are well advised to take possible creditor concerns into account when drawing up the pre-pack and to ensure that they can present the advantages of the pre-pack to the composition court in a comprehensible and robust manner as the best possible.

Pre-pack solutions also entail certain risks from the debtor's perspective, as the submission of the application for a debt restructuring moratorium (and approval of the pre-pack) largely transfers control over further steps to the composition court (and in some cases the administrator).

Although the debtor can take certain measures to increase the likelihood of the debt restructuring moratorium being granted and the pre-pack being approved, certainty that the composition court will grant the (provisional) moratorium and approve the pre-pack cannot be obtained in advance. In the worst case scenario, the court could even open bankruptcy proceedings directly due to the debtor's inability to reorganise.

Implementation

Pre-packs are typically structured as a transferring reorganisation – ie, as the transfer of a business or part of a business to a new legal entity (often an existing or newly founded rescue company). However, continuing reorganisations are also possible if, for example, fixed assets are to be sold to alleviate an acute liquidity crisis in order to enable the company in need of reorganisation to continue operations (possibly together with other measures).When preparing a pre-pack, it will be necessary to hold regular discussions with various parties. These include not only potential acquirers of parts of the business or assets, but also important contractual partners (landlords, major suppliers, etc), (financial) creditors, members of management and employees who are needed for the reorganisation, the owners (if applicable), etc.

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. In practice, confidentiality agreements and strict adherence to need-to-know principle are used to achieve this goal.

In view of the fact that the composition court will only authorise a pre-pack if no better alternative for the debtor's creditors is foreseeable, particular attention should be paid to the price for the parts of the business or assets to be sold. It can be helpful in this respect to conduct an auction procedure or to obtain valuations (eg, from an involved financial or M&A advisor). Particular attention must be paid to this aspect if the transferee is especially close to the debtor.

The contract negotiated as part of a pre-pack for the takeover of certain parts of the business or assets is regularly subject to the suspensive condition that the composition court authorises the provisional debt restructuring moratorium

for the debtor (if necessary for the restructuring as a "silent" moratorium) and approves the conclusion of the planned legal transactions. Apart from these obvious conditions, the contractual pre-pack arrangements should be as unconditional as possible, as a composition court might otherwise 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 completion of the pre-pack.

In addition to the conditions mentioned above, contracts in pre-pack situations often stipulate that the contract lapses if the debt restructuring moratorium and the pre-pack are not approved by the composition court by a certain date (the so-called 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 composition court have sufficient time to assess and, if necessary, approve the pre-pack after the application for a debt restructuring moratorium has been submitted, but, on the other, there is not enough time to find alternative solutions during the debt restructuring moratorium. In practice, recent court cases have shown that a few days are sufficient to get court approval in situations that are not overly complex.

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 a provisional debt restructuring moratorium. If necessary for the success of the pre-pack, the debtor will apply to waive publication of the deferral. In this case, a provisional administrator must be appointed.

A "silent" moratorium (ie, waiver of publication) is particularly important in cases where the business activities of the (part of the) business to be transferred could be damaged if the debt restructuring moratorium becomes known. In these situations, the transferee will typically demand during contract negotiations that a silent deferral be applied for and approved.

The debtor can propose a possible provisional administrator in the application for a provisional debt restructuring moratorium. It is also possible and may make sense to discuss the pre-pack concept with the potential administrator, at least in outline, before submitting the application for a moratorium in order to ensure that the potential administrator has no fundamental objections to the procedure or the planned measures. It is important to ensure that the independence of the potential administrator is not impaired.

If the composition court confirms the provisional debt restructuring moratorium, it will generally appoint a provisional administrator who will review the 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 involved (prospective buyer, creditors, etc) before deciding on the pre-pack.

In exceptional cases – namely in the case of great urgency and "clear circumstances" – the composition court can also decide on the pre-pack without appointing an administrator. In the recent past, courts have shown themselves willing to make use of this exception, particularly when it came to preserving jobs.

For example, a district court ruled only two working days after receipt of the application in full in line with the requests made; namely (i) approving the provisional debt restructuring moratorium, (ii) approving the application

to refrain from appointing a provisional administrator, and (iii) approving the negotiated takeover agreement (pre-pack) between the debtor and a prospective buyer. The main motivation for the court in this case was the fact that this quick and uncomplicated procedure was the only way to save a majority of the jobs in the insolvent company and to transfer significant parts of the insolvent business to a rescue company.

After approval

The authorisation of the pre-pack by the debt restructuring court means that the corresponding legal transaction cannot be contested. The fate of the residual company depends on the applications in the application for debt restructuring moratorium and the specific circumstances. In principle, all available options are possible – ie, cancellation of the debt restructuring moratorium (exit), continuation of the debt restructuring proceedings and conclusion of a debt restructuring agreement or the opening of bankruptcy proceedings if there is no prospect of restructuring, and conclusion of a debt restructuring agreement.

Outlook

It is not entirely clear whether the high number of insolvencies expected in Switzerland in 2023 is still due to the government aid measures enacted during the coronavirus pandemic (and not continued after the pandemic) or whether this figure already includes insolvencies that are primarily attributable to the changes in the interest rate landscape last year. In any case, it can be assumed that the more difficult conditions for securing corporate financing will lead to further insolvencies. Against this backdrop, it is to be welcomed that the change in the law in Switzerland in 2014 and the pragmatic assessment of pre-pack transactions by Swiss courts have led to more companies being able to spin off viable parts of their businesses, in some cases with a significant number of jobs retained, and transfer them to a new owner as part of a pre-pack, even in bankruptcy situations.

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