COVID-19 Update

Insolvency and Restructuring

16 April 2020

Easing of insolvency filing obligations and 'moratorium-lite'

On April 16, 2020, the Swiss Federal Council enacted the COVID-19 Insolvency Ordinance. One of its main goals is to relieve pressure on executive bodies of Swiss entities to request the opening of insolvency proceedings. Relief is targeted at over-indebtedness situations caused by negative impacts of the COVID-19 pandemic on liquidity, earnings and going-concern prospects. Further, the Swiss Federal Council put in place a special COVID-19 moratorium. This 'moratorium-lite' will facilitate SMEs' fast access to a protective moratorium with less formal requirements than would otherwise apply under the general composition moratorium. The 'moratorium-lite' replaces the general suspension of debt enforcement proceedings ordered by the Swiss Federal Council earlier in the COVID-19 crisis, which will expire on April 19, 2020.

The Swiss Federal Council has supplemented the measures aimed at mitigating the impact of the COVID-19 pandemic on the Swiss economy by adding another pillar focussing on insolvency provisions. Similar to projects in other jurisdictions, the new COVID-19 Insolvency Ordinance temporarily allows executive bodies of Swiss companies not to notify the courts of an existing balance sheet over-indebtedness and to continue trading on the basis of an overall positive assessment of the future ability of the company to restructure its balance sheet by December 31, 2020. In addition, access of small and medium sized entities (SMEs) to a protective moratorium has been facilitated by introducing a special COVID-19 moratorium or 'moratorium-lite' with less stringent formal requirements.

1. Easing of filing obligations

Current strict filing obligation: Swiss corporate law establishes a strict insolvency filing obligation on executive bodies of Swiss companies in case of balance sheet over-indebtedness. The current law only knows two exceptions:

- the existence of deeply subordinated loans or other claims in an amount sufficient to cover the over-indebtedness[1]; or

[1] According to best corporate practice expected future losses will also have to be covered.

- good prospects that a financial restructuring of the company can be achieved in a reasonably short term.

Constant monitoring duty: Over-indebtedness is not only to be tested against most recent annual financials. Rather, executive bodies are held to draw up interim financials if there is a concern (*begründete Besorgnis*) that the company may be over-indebted. Such interim balance financials are to be drawn up at going concern and liquidation values and must, as a rule, be audited. A filing obligation exists where both balance sheets show an over-indebtedness.[2] The filing may take the form of a request for the opening of bankruptcy proceedings, for the grant of a composition moratorium or for a deferral of bankruptcy. Non-compliance with the filing obligation exposes the members of the executive bodies to the risk of personal liability for damages caused by the delayed filing. Auditors are subject to a subsidiary filing obligation in case of an obvious over-indebtedness.

Fear of COVID-19 related insolvency wave: The impact of the COVID-19 pandemic on the prospects of a company is currently very difficult if not impossible to assess. This is obvious for companies whose business activities are directly affected by the current lockdown, where uncertainty exists not only in relation to the duration of the relevant measures but also with respect to the potential of catch-up effects and long-term changes in consumer attitudes. In addition, many other companies not directly affected by the lockdown are experiencing severe decline in demand for various reasons such as supply chain issues, failing customers etc. In such times of widespread uncertainty, projecting cash flows and earnings as well as assessing the sustainability of the going-concern assumption are very demanding tasks for companies of all size.

Easing of filing obligation: To remove pressure from executive bodies and to avoid premature insolvency filings in view of daunting liability risks, the Swiss Federal Council has now ordered that companies with a healthy balance sheet (no over-indebtedness) as per December 31, 2019 will not have to comply with insolvency filing requirements established under Swiss law, if:

- there are prospects (*Aussicht*) that the company will have a 'clean' balance sheet (no over-indebtedness) by December 31, 2020; and
- the company was not over-indebted as per December 31, 2019.

In addition, while corporate executives will still have to prepare interim financials in case of a concern of over-indebtedness, it will not be necessary to have such interim financials audited. As a result of the public consultation process, it has further been clarified that the subsidiary filing obligation of auditors will be equally suspended. This allows for a dialogue between executive bodies and statutory auditors.

Documentation requirement and BJR: The prospect analysis is a non-transferable and unalienable duty of the highest executive bodies of a company and requires a transparent and informed business decision, which is to be appropriately documented in writing. Conflict of interest situations will have to be avoided. If such requirements are adhered to, it is to be expected (and the commentary from the Swiss Federal Office of Justice to the COVID-19 Insolvency Ordinance implies) that Swiss courts will avail protection to executive bodies under the business judgment rule, i.e. not interfere with business judgment applied by executive bodies unless the assessment of the prospect analysis was manifestly unsustainable.

Deficiency of new rule: Unfortunately and despite much criticism in the public consultation process, companies which were technically over-indebted at December 31, 2019 but which, under existing rules, are allowed to continue trading because of sufficient deep subordinations will not benefit from the relaxed filing obligations. Rather, such companies will be left with the choice to (i) secure additional deep subordinations to cover the increased amount of over-indebtedness whilst maintaining the going

[2] If the going-concern assumption is not sustainable, though, only liquidation values are relevant.

concern (possibly through injection of additional liquidity), (ii) restructure in a reasonably short term or (iii) proceed with an insolvency filing. Among others, it is to be expected that many early stage start-ups will be left with these options only given their special balance sheet structure.

2. 'Moratorium-lite'

Lapse of suspension of debt enforcement actions: For certain businesses heavily affected by the COVID-19 pandemic it may not be possible to make it through the crisis without any formal protection from creditor action. Until April 19, 2020, debtors are generally protected from many such actions on the basis of the suspension of limitation periods for the entire collection system.[3] However, extending this protection was considered to be both incomplete (no protection against certain creditor steps such as attachment orders and private realization of collateral) and impracticable because of unintended consequences (suspension applied to all debtors which may have negative effects on payment practice generally).

Perceived complexity of composition moratorium: Current Swiss insolvency laws allow debtors to seek relief from creditors under a so-called composition moratorium. Since 2014, this composition moratorium may be applied for as a standalone restructuring tool, which is not necessarily to be followed by a second stage negotiation of a composition agreement with the creditors. As such, the composition moratorium would be an option also for COVID-19 affected businesses. That said, composition moratorium proceedings are still not widely used in practice by SMEs. This is so mainly because of a perceived complexity of the process, the frequent involvement of a court appointed administrator and the resulting costs.

'Moratorium-lite' as remedy: On that basis, the Swiss Federal Council has now enacted legislation, which is aimed at making available the benefits of a composition moratorium also to SMEs without the perceived disadvantages. The 'moratorium-lite' will be granted by the court and will stall most creditor actions in Switzerland to give some breathing space to SMEs. Claims which came into existence prior to the grant of the 'moratorium-lite' may not be settled with the exception of certain privileged claims, including in particular employees' salary claims and related pension claims. In turn, claims which come into existence during the 'moratorium-lite' may be settled unless this would jeopardize the legitimate interests of creditors or would result in a creditor preference. While pursuing business activities is generally permitted, certain dispositions such as the granting of collateral or the disposal of non-current assets require court consent.

Key distinctions of 'moratorium-lite': The main differences between the 'moratorium-lite' and the general moratorium are as follows:

- The moratorium-lite is available to SMEs only (but not to listed and large[4] companies);
- the 'moratorium-lite can only be applied for by the SME seeking protection (but not by its creditors);
- the applicant must have been balance sheet 'healthy' (no over-indebtedness) as per December 31, 2019. This requirement is aimed at ensuring that the 'moratorium-lite' will not be used for entities which were in distress prior to the COVID-19 pandemic. That said and in contrast to what is outlined above for the easing of filing obligations, companies showing an over-indebtedness as per December 31, 2019 which, at that time, was covered by deep subordinations may apply for a 'moratorium-lite';
- the financial information to be provided to the court is less specific than under a composition moratorium but must make plausible the applicant's financial position to the extent possible;
- the duration of the 'moratorium-lite' is initially up to three months (one time extension by up to three months possible);

[3] See COVID-19 Update March 18, 2020.

[4] Companies which exceeded two of the following criteria in 2019: Balance sheet sum of CHF 20m; earnings of CHF 40m; 250 FTEs in yearly average.

- a court appointed administrator is the exception (rather than the rule as in the general moratorium);
- the moratorium will always be public (no silent 'moratorium-lite') and the SME will have to inform its creditors proactively once the 'moratorium-lite' has been granted;
- while the 'moratorium lite' generally offers protection against creditor action, certain remedies of a general moratorium do not apply: (1) Interest continues to accrue during the 'moratorium lite', (2) court and administrative proceedings are not suspended automatically, (3) it will not be possible for an administrator to order the conversion of non-monetary claims into monetary claims and (4) long term agreements cannot be terminated to facilitate the restructuring even if an administrator is appointed;
- no specific 'exit' rules apply to the 'moratorium lite', i.e. the SME will be operating under regular rules again once the term of the 'moratorium-lite' has expired. There will not be any court involvement at this stage; and
- as in the composition moratorium, super-priority of claims coming into existence during the 'moratorium lite' requires consent from the administrator. However, as administrators will be the exception for the 'moratorium lite', creditors may not expect to benefit from a super-priority.

If a 'moratorium-lite' will be applied for, the COVID-19 Insolvency Ordinance clarifies that the executive bodies of the relevant entity will have complied with their filing obligations in case of over-indebtedness.

Liquidity pressure: It remains to be seen whether the 'moratorium lite' will be used widely in practice. Given that it will become public and in view of the fact that creditors continuing to pursue business activities with the debtor will not generally benefit from super-priority rights, it may, at least in a first phase, increase pressure on liquidity, as many counterparties will insist on prepayments or retainers. In this respect, it remains to be seen whether businesses wishing to apply for a 'moratorium lite' will still be granted access to COVID-19 loans. Unlike in the first draft (which excluded this option), this is at least legally permissible.

3. Amendments for general moratorium

Finally, certain amendments have been implemented for the general moratorium. In particular, applicants are currently not requested to provide a restructuring plan to the court together with the request for the grant of a provisional composition moratorium (i.e. the first stage of the general moratorium) as such document would be difficult to produce in the current uncertainty. Further, the maximum duration of the provisional moratorium has been extended to six months (previously: four months). Finally and until May 31, 2020, courts will not have to open bankruptcy proceedings *ex officio* in case of uncertainties regarding the prospects of the successful restructuring provided, however, that the relevant debtor was not over-indebted as per December 31, 2019 or such over-indebtedness was covered by sufficient deep subordinations.

4. Entering into force and duration

The COVID-19 Insolvency Ordinance enters into force at midnight on April 20, 2020 and, subject to any extension ordered by the Swiss Federal Council, expires six months thereafter.

Please do not hesitate to contact us in case of any questions.

Legal Note: The information contained in this COVID-19 Update is of general nature and does not constitute legal advice. In case of particular queries, please contact us for specific advice.

Your contacts

Zurich

Tanja Luginbühl
tanja.luginbuhl@lenzstaehelin.com
Tel: +41 58 450 80 00

Roland Fischer
roland.fischer@lenzstaehelin.com
Tel: +41 58 450 80 00

Geneva / Lausanne

Andreas Rötheli
andreas.roetheli@lenzstaehelin.com
Tel: +41 58 450 70 00

Roman Graf
roman.graf@lenzstaehelin.com
Tel: +41 58 450 70 00

Our offices

Zurich
Lenz & Staehelin
Brandschenkestrasse 24
CH-8027 Zürich
Tel: +41 58 450 80 00
Fax: +41 58 450 80 01

Geneva
Lenz & Staehelin
Route de Chêne 30
CH-1211 Genève 6
Tel: +41 58 450 70 00
Fax: +41 58 450 70 01

Lausanne
Lenz & Staehelin
Avenue de Rhodanie 58
CH-1007 Lausanne
Tel: +41 58 450 70 00
Fax: +41 58 450 70 01

www.lenzstaehelin.com