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Global Legal Group

The International Comparative Legal Guide to: Corporate Recovery and Insolvency 2011

A practical cross-border insight into corporate recovery and insolvency

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URL: www.glgroup.co.uk

GLG Cover Design

F&F Studio Design

GLG Cover Image Source

Stock.XCHNG

Printed by

Ashford Colour Press Ltd
June 2011

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ISBN 978-1-908070-03-6
ISSN 1754-0097



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Switzerland



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1 Issues Arising When a Company is in Financial Difficulties

1.1 How does a creditor take security over assets in Switzerland?

Asset security granted under Swiss law can be classified under three broad categories: (i) mortgages on real estate; (ii) rights of pledge on movable goods, claims and other rights; and (iii) transfers of movable goods and assignments of claims for security purposes.

(i) Mortgages (*Grundpfand/hypothèque*) offer broad protection to secured creditors and are, in practice, typically used under the form of mortgage certificates (*Schuldbrief/cédule hypothécaire*); (ii) the pledge (*Faustpfand/nantissement*) is a widely used form of collateral for movable goods, claims and other rights (such as, e.g., intellectual property rights). By charging a pledge on specific assets, the pledgor retains title in such assets, granting, however, preferential enforcement rights to the pledgee who may satisfy its claims out of the realisation proceeds of the pledged asset. It is a condition under Swiss law for the perfection of a pledge over movable goods to transfer possession of such goods to the pledgee or to a third party pledge holder. As a result of the above, the concept of a floating charge purporting to charge all movable assets, stock and inventory of the debtor in favour of the creditor is ineffective under Swiss law; (iii) the most important alternative forms of collateral are the transfer of movable or immovable goods and securities or the assignment of claims for security purposes. Both transfer and assignment for security purposes imply a transfer of title from the debtor (which, consequently, needs to be the owner of the transferred property or the holder of the transferred claim) to the creditor, albeit on a fiduciary basis. This means that the transferee/assignee is committed towards the transferor/assignor to strictly exercise the granted rights in compliance with the purpose of the security and, in particular, to retransfer or reassign such property or claims once the secured claim is repaid or the security is otherwise released. A general deed of assignment whereby a debtor assigns for security purposes all existing and future trade receivables is generally deemed to be valid under Swiss law.

1.2 In what circumstances might transactions entered into whilst the company is in financial difficulties be vulnerable to attack?

According to the Swiss Federal Act on Debt Enforcement and Bankruptcy (DEBA) certain preferential or fraudulent acts made by the debtor within certain suspect periods may become subject to challenge. The avoidance regime set forth in articles 285 *et seq.*

DEBA provides for three different avoidance actions (*Anfechtungsklage/action révocatoire*), i.e.: (i) the action to avoid gratuitous transactions (*Schenkungsanfechtung/révocation des libéralités*), which targets, in particular, all gifts and all dispositions made by the debtor without any or without adequate consideration during the year prior to the opening of bankruptcy proceedings, the granting of a moratorium or the seizure of assets; (ii) the voidability of certain specified transactions during the year prior to the opening of bankruptcy proceedings, the granting of a moratorium or the seizure of assets while the debtor is already over-indebted (*Überschuldungsanfechtung/revocation en cas de surendettement*), i.e. the granting of a security interest for existing debts without being by prior agreement contractually obligated to create the relevant security interest, the settlement of a monetary claim in a manner other than by usual means of payment, or the payment of a debt which was not yet due, in each case provided that the recipient is unable to prove that it was unaware and must not have been aware of the debtor's over-indebtedness; and (iii) the avoidance for intent (*Absichtsanfechtung/révocation pour dol*) which targets dispositions and other acts made by the debtor within a period of five years prior to the opening of bankruptcy proceedings, the granting of a moratorium or the seizure of assets if the disposition was made by the insolvent with the intent to disadvantage its creditors or to prefer certain of its creditors to the detriment of other creditors and if the privileged creditor knew or should have known of such intent. For all challenges it is further required that the plaintiff is able to establish that the challenged transaction has caused damages to other creditors of the debtor. In recent case law the Swiss Federal Supreme Court tends to apply rather low standards for a successful avoidance for intent which makes it more difficult for financial and other creditors to assess avoidance risks when dealing with a debtor in financial distress.

1.3 What are the liabilities of directors (in particular civil, criminal or disqualification) for continuing to trade whilst a company is in financial difficulties in Switzerland?

The issue of director's liability typically arises when a company has been declared bankrupt. The general legal basis as regards the civil liability of directors (*Haftung für Geschäftsführung/responsabilité dans la gestion*) is article 754 of the Swiss Code of Obligations (CO), pursuant to which the members of the board of directors and any person entrusted with the management or the liquidation of a corporation shall be liable for damages "caused by wilful or negligent violation of their duties". Accordingly, the liability of a director requires: (i) a breach of the director's duties; (ii) damages caused to the corporation or a particular creditor; (iii) a wilful or negligent conduct (fault); and (iv) a causal link between the breach

and the damage. Damages typically cover the increase of loss which occurred between the moment the directors should have known the corporation's distressed situation and failed to take appropriate actions (see question 2.2 below) and the moment the bankruptcy was actually declared. According to the above, courts have held directors who failed to take the steps required by law, by not notifying the court about the over-indebtedness of the company, liable. Several provisions of the Swiss Criminal Code (**CrimC**) may also apply in the context of the activity undertaken by a director (*Misswirtschaft/gestion fautive; Bevorzugung eines Gläubigers/avantages accordés à certains créanciers*). Article 165 CrimC punishes the debtor whose acts of mismanagement have caused the company's bankruptcy. This criminal provision expressly refers to the case of the debtor who by means of an insufficient capital endowment causes or aggravates its over-indebtedness before being declared bankrupt. Special attention must also be paid to article 167 CrimC which deals with the issue of the advantages granted to certain creditors by an insolvent debtor who is subsequently declared bankrupt. As for disqualification (*Berufsverbot/interdiction d'exercer une profession*) issues, article 67 par. 1 CrimC - which is in fact very rarely implemented - provides that the court may prevent a convicted person from exercising their profession for a period extending from six months to five years if this person has been convicted of an imprisonment sanction exceeding six months or a fine of 180 days' rates for an offence committed within the exercise of a profession when the circumstances give reason to fear new abuses from the convicted person.

2 Formal Procedures

2.1 What are the main types of formal procedures available for companies in financial difficulties in Switzerland?

There are two main types of insolvency proceedings in Switzerland: bankruptcy (i.e. liquidation) proceedings (*Konkursverfahren/faillite*); and composition proceedings (*Nachlassverfahren/concordat*). Composition proceedings can either: (i) be used to liquidate and realise the debtor's assets in a more flexible manner than in bankruptcy (composition agreement with assignment of assets); or (ii) result in a debt restructuring (be it through a debt-rescheduling or a dividend agreement or a combination thereof).

2.2 What are the tests for insolvency in Switzerland?

There are different tests for initiating insolvency proceedings against a debtor: (i) if a debtor is qualified to be insolvent (*zahlungsunfähig/insolvable*), i.e. if the debtor is no longer able to pay its debts as they fall due. Insolvency, however, only leads to the initiation of bankruptcy proceedings upon a respective request by the debtor itself; (ii) if a debtor has ceased to pay its debts (*Zahlungseinstellung/cessation de paiement*) in which case a creditor may request the opening of bankruptcy proceedings; or (iii) if a debtor is over-indebted (*überschuldet/surendetté*) within the meaning of article 725 par. 2 CO, i.e. if the company's liabilities exceed its assets.

If the last annual balance sheet shows that half of the stated share capital and the legal reserves is no longer covered by the company's assets, the board of directors must without delay convene a shareholders' meeting and propose measures to financially reorganise the company. If the board of directors has reason to believe that the company is over-indebted, it must draw up an interim balance sheet and submit it to the auditors for examination.

If the interim balance sheet shows that the liabilities are neither covered if the assets are appraised at values on a going concern basis nor at liquidation values, the board of directors must notify the court, i.e., file for bankruptcy or apply for a postponement of bankruptcy unless (i) there is a subordination of claims and good prospects of financial restructuring of the company in due course, or (ii) there are serious reasons to believe that the company may be financially restructured in short time.

2.3 On what grounds can the company be placed into each procedure?

A company may be declared bankrupt by the competent court and placed into bankruptcy proceedings: (i) if a creditor whose claim has not been settled but upheld within the course of debt enforcement proceedings (*Betreibung/poursuite*) has successfully requested for the opening of bankruptcy proceedings (*Konkursbegehren/réquisition de faillite*); (ii) upon a debtor's request by declaring to the court that it is insolvent; (iii) upon a creditor's request if the company has committed certain acts to the disfavour of its creditors or if it has ceased payments or if certain events have happened during composition proceedings; or (iv) upon a notification of the court by the board of directors (or the statutory auditors) of the company that the company is over-indebted within the meaning of article 725 par. 2 CO.

Composition proceedings are typically initiated by the debtor, but can also be requested by a creditor if such creditor is entitled to request the opening of bankruptcy proceedings. As a first step, a reasoned formal application for a moratorium has to be submitted to the composition court. Furthermore, composition proceedings may also be opened *ex officio* if it appears to the bankruptcy court that a composition agreement is likely to be concluded with the creditors.

2.4 Please describe briefly how the company is placed into each procedure.

In case a creditor has successfully completed prior debt enforcement proceedings, the debtor is issued a bankruptcy warning (*Konkursandrohung/comination de faillite*) to the effect that bankruptcy proceedings will be opened unless payment is forthcoming. Upon the expiry of 20 days after service of the bankruptcy warning, the creditor may request that bankruptcy proceedings be opened. The court will then summon the parties for a hearing on short notice. Unless very limited objections are sustained or procedural rules have been violated, the debtor is declared bankrupt (case (i) above). Bankruptcy may, as described above, also be declared upon the debtor's or a creditor's request (cases (ii) and (iii) above) or upon the notification of the court by the board of directors of the company in case of over-indebtedness (case (iv) above). Upon declaration of bankruptcy, all assets of the debtor form the bankruptcy estate, which is used to satisfy the creditors' claims. The debtor is deprived of its capacity to dispose of its assets and from the date of declaration of bankruptcy it will be represented exclusively by the bankruptcy administrator (*Konkursverwalter/administrateur de la faillite*). All obligations of the debtor become immediately due and payable, except for claims which are secured by mortgages on real estate. In general, interest stops to accrue at the date of the bankruptcy declaration.

Composition proceedings are typically opened upon the debtor's request filed with the composition court. Upon receipt of such a request the court typically orders provisional measures deemed appropriate and necessary for conserving the debtor's assets and may, in particular, grant a provisional moratorium (*provisorische Nachlassstundung/sursis provisoire*) of up to two months.

Furthermore, a provisional administrator (*provisorischer Sachwalter/commissaire provisoire*) may be appointed by the court to permit an assessment of the debtor's assets, its financial condition and the prospects of a successful reorganisation. If the court finds that a composition agreement is likely to be concluded, it must grant the definitive moratorium (*definitive Nachlassstundung/sursis concordataire*) for a period of four to six months (in particularly complex cases up to 24 months) and appoint an administrator (*Sachwalter/commissaire*). During the definitive moratorium the administrator seeks to negotiate a composition agreement with the creditors, while creditors of claims other than first class claims (see question 3.1 below) or claims secured by real estate are not entitled to commence or continue debt enforcement proceedings. Realisation of collateral is not permitted during the moratorium. The debtor is restricted in its ability to dispose of certain of its assets and there are certain restrictions as to its power to manage the company's affairs.

2.5 What notifications, meetings and publications are required after the company has been placed into each procedure?

First, the bankruptcy court will determine whether summary or ordinary proceedings will apply or whether the bankruptcy proceedings are closed because the assets are not sufficient to cover the costs of the proceedings. For this purpose the bankruptcy administrator has to draw up an inventory. Summary proceedings are ordered if the proceeds of the bankrupt's assets are unlikely to cover the costs of ordinary proceedings or in non-complex circumstances, in each case unless one or more creditors explicitly request ordinary proceedings and are willing to advance the additional costs.

If the rules for ordinary bankruptcy proceedings apply, the bankruptcy estate is administered as follows: the bankruptcy administrator publishes a notice of bankruptcy, instructing all creditors and debtors to file their claims and debts within 30 days and inviting creditors to a first creditors' meeting (*erste Gläubigerversammlung/première assemblée des créanciers*). The first creditors' meeting may appoint a private bankruptcy administrator acting instead of the state bankruptcy office as well as a creditors' committee which has certain supervisory (and limited decisive) competencies. A second creditors' meeting (*zweite Gläubigerversammlung/seconde assemblée des créanciers*) is convened to pass resolutions as to all important matters, including the commencement or continuation of claims against third parties and the method of realisation of the assets belonging to the bankruptcy estate (the actual realisation, however, is reserved to the bankruptcy administrator).

If the rules for summary bankruptcy proceedings apply, there are, in principle, no creditors' meetings and the bankruptcy office will proceed to liquidation and realisation of the assets (including collateral) without participation of the creditors. Certain rights of the secured parties to oppose to particular realisation methods of their collateral remain reserved.

Composition proceedings start with the grant of a moratorium, upon which the administrator takes the necessary preparatory measures for the following process of creditor and court approval of the composition agreement. An inventory is taken and the assets are valued. The administrator makes a public announcement instructing the creditors to file their claims within 20 days (*Schuldenruf/appel aux créanciers*). All claims which have arisen either before the public announcement of the moratorium or without the administrator's consent during the moratorium are subject to the composition agreement. As soon as a draft composition agreement is proposed, the administrator convenes a creditors' meeting by

public notice. Only creditors who have filed claims are admitted with the right to vote to the creditors' meeting. The creditors' meeting receives a report of the administrator, elects the liquidator and the members of the creditors' committee and decides whether to approve or to reject the proposed composition agreement. Approval of the proposed composition agreement requires the affirmative vote by a quorum of either (a) a majority of creditors representing two-thirds of the total debt or (b) one-fourth of the creditors representing three-fourths of the total debt. Creditors with privileged claims and secured creditors (to the extent that their claims are covered by the estimated liquidation proceeds of the collateral) will not be entitled to vote on the composition agreement. After approval by the creditors, the composition agreement requires confirmation by the composition court. With the court's approval, the composition agreement becomes valid and binding upon all creditors of claims subject to the composition agreement whether or not they have participated in the composition proceedings.

3 Creditors

3.1 Are unsecured creditors free to enforce their rights in each procedure?

In bankruptcy proceedings, all unsecured creditors are entitled to claim the amount of principal plus interest until and including the date of the declaration of bankruptcy. Apart from attending the creditors' meetings, unsecured creditors have no individual rights to enforce their claims through realisation of any of the debtors' assets. It is in the sole competence of the bankruptcy administration to realise the debtors' assets. Unsecured creditors' claims are successively satisfied out of the realisation proceeds according to the order of priority as further described under question 5.2 below.

In composition proceedings only creditors who have timely filed claims are admitted with the right to vote to the creditors' meeting. Failure to file the claims within the 20-day period, however, does not affect the creditor's entitlement to the composition proceeds which, in case of a composition agreement with assignment of assets, are distributed in the same consecutive order as in bankruptcy proceedings.

3.2 Can secured creditors enforce their security in each procedure?

In bankruptcy proceedings, secured creditors have to hand in the collateral to the bankruptcy administration and have no right to realise the collateral privately, but will be satisfied in priority of any other creditors out of the net proceeds of the sale of such collateral. This holds true for all movable assets which have been pledged to the secured creditor (rather than transferred for security purposes). Additional exceptions apply to intermediated securities which are traded at a representative market pursuant to the Swiss Federal Act on Intermediated Securities. In turn, real estate mortgages are only realised and proceeds paid out to the creditors if their claims against the debtor are due; claims secured by real estate mortgages that are not yet due are assigned to the acquirer of the real property.

In composition proceedings leading to a composition agreement with assignment of assets (*Nachlassvertrag mit Vermögensabtretung/concordat par abandon d'actifs*) secured creditors with a pledge on moveable assets are not obliged to deliver the collateral to the liquidator. After the moratorium they are generally entitled to liquidate the pledged collateral by official enforcement proceedings or, if the pledge agreement so provides, by private sale.

3.3 Can creditors set off sums owed by them to the company against amounts owed by the company to them in each procedure?

Swiss insolvency law has several impacts on the right to set off which apply irrespective of applicable substantive law.

First, a distinction needs to be made between (i) claims of the insolvent party forming part of the insolvency estate and claims against the insolvent party (*Konkurs- oder Nachlassforderungen/créances dans la faillite ou le concordat*) to be satisfied with dividend payment out of the proceeds of the insolvency estate on the one hand, and (ii) claims of and against the insolvency estate (*Masseforderungen und -verbindlichkeiten/créances et dettes de la masse*) which are mainly characterised by the fact that they have come into existence only after the opening of insolvency proceedings with the consent of the insolvency administration. As a rule, set-off is only possible between claims of the same category. Legal doctrine holds, though, that a creditor may set off its claim against the insolvency estate with a claim of the insolvent debtor.

In addition, set off of claims of the first category is not admissible if (i) the debtor of the insolvent party became creditor of the latter only after the opening of bankruptcy proceedings or the grant of a moratorium, respectively, or (ii) the creditor of the insolvent party did not become a debtor of the insolvent party or the insolvency estate until after the opening of the bankruptcy proceedings or the grant of a moratorium, respectively. In other words, the creditor of an insolvent party may as a rule set off its claims against debts it has towards the insolvent provided both the claims and the debts existed at the time of the bankruptcy decree or the grant of a moratorium, respectively.

Furthermore, set off is voidable if a debtor of the insolvent party acquires a claim against the latter prior to the opening of bankruptcy proceedings or the grant of a moratorium, respectively, but in awareness of the insolvency in order to gain an advantage for himself or a third party to the detriment of the insolvency estate.

4 Continuing the Business

4.1 Who controls the company in each procedure? In particular, please describe briefly the effect of the procedures on directors and shareholders.

Immediately after the filing of the request to open bankruptcy proceedings, the court can order conservatory measures (*vorsorgliche Anordnungen/measures conservatoires*) necessary for safeguarding the creditors' rights. For example, the court can forbid certain payments or order the business to close. Once bankruptcy proceedings have been opened, the debtor is deprived of its right of disposal of its assets. The signing authority of directors and other authorised signatories expires and shareholder meetings will no longer be held. A claim forming part of the bankruptcy estate can no longer be validly discharged by payment to the debtor; such payment only amounts to a valid discharge to the extent that it is received by the bankruptcy estate (*Zahlungen an den Schuldner/paiements aux mains du failli*). All pending enforcement proceedings against the debtor cease and new enforcement proceedings relating to claims which arose before the opening of bankruptcy proceedings are not permissible. With the exception of urgent matters, civil court actions to which the debtor is a party and which affect the composition of the bankruptcy estate are stayed. If a creditors' committee is appointed during the first meeting of creditors such committee may have the task to authorise the continuation of the debtor's business or trade, under specific

conditions, whereas such continuation of business will have to be pursued by the bankruptcy authority. This committee is also allowed to supervise the management activities of the bankruptcy administration and to object to any measures which contravene the creditors' interests.

During the moratorium, the court appoints an administrator, who supervises the debtor's activities. The debtor may continue its business activities under the supervision of the administrator and the power to take corporate resolutions remains with the board of directors and the shareholders. The composition court may, however, direct that certain acts shall require the administrator's participation in order to be legally valid, or authorise the administrator to take over the management from the debtor. Without the authorisation of the composition court, the debtor is prohibited during the moratorium to divest, encumber or pledge assets which are affected to business, to grant guarantees or to make gifts. Without court approval any such transactions are null and void. During the moratorium, enforcement proceedings can neither be initiated nor continued, except for enforcement proceedings leading to seizure for first class claims or for the realisation of collateral for claims secured by a mortgage of real estate, whereas the realisation of the collateral as such is prohibited. Once a composition agreement with assignment of assets has been approved by the creditors and the court, the effects on the directors and shareholders are similar as in bankruptcy. In turn, if a debt-rescheduling or dividend agreement is entered into, the responsibilities of directors and shareholders are fully reinstated.

4.2 How does the company finance these procedures?

Enforcement proceedings trigger costs. Debts linked to the liquidation of the bankruptcy have to be paid with priority. These debts are called debts of the bankruptcy estate (*Masseverbindlichkeiten/dettes de la masse*). All costs for the opening and carrying out of the bankruptcy proceedings and for the drawing up of the inventory are paid directly out of the proceeds. The debts of the estate are thus paid prior to the payment of any dividend to the ordinary creditors. In case there are no assets at all that can be realised, the bankruptcy administration shall pronounce the closure of the bankruptcy proceedings or invite the interested creditors to make an advance to cover the costs of the procedure.

The above rules apply to the composition proceedings.

4.3 What is the effect of each procedure on employees?

Employment agreements are not automatically terminated upon the declaration of bankruptcy of the employer or the employee. In case the employer becomes insolvent, though, an employee may terminate the employment relationship without notice unless such employee is provided security for claims arising from the employment relationship. Subject to such termination rights, the bankruptcy administration may decide to maintain some employment contracts. The administration may also, as it happens in the majority of cases, cease the business and therefore decide to terminate the work contracts. When doing so it has to comply with the applicable notice period. Unpaid salaries have to be claimed and scheduled.

Although there are some unsettled legal controversies, composition proceedings have a legal effect that is similar to bankruptcy with respect to employment contracts.

4.4 What effect does the commencement of any procedure have on contracts with the company and can the company terminate contracts during each procedure?

There are certain types of contracts that are terminated, *ex lege*, as is the case with insurance contracts, agency or simple partnerships, whereas others can be terminated immediately by one party in case of bankruptcy of the other (see e.g. employment contract, lease for rent or loan for consumption). The remaining contracts are not automatically affected by bankruptcy, which means that the bankruptcy estate and the contracting party are still bound unless the very contract provides for an automatic termination or a termination right. While the contracting party would have to perform in kind its obligations under an agreement which has not been terminated, the rights of the contracting party are affected by the principle of equality among creditors, as a result of which it is bound to accept a dividend rather than full payment or specific performance. However, should the bankruptcy administration elect to pursue the performance of a contract which had not or only partially been fulfilled at the time of opening of the bankruptcy proceedings, the other party to the contract may demand that security be provided, and it may further expect full performance by the bankruptcy authority. The right of the bankruptcy administration to elect performance of the contract is excluded in the case of financial future, swap, option and similar strict deadline transactions, if the value of the contractual performance can be determined based on market or stock exchange prices at the time of the opening of the bankruptcy. The bankruptcy administration and the contractual partner are each entitled to claim the difference between the agreed value of the contractual performance and the market value at the time of the opening of the bankruptcy proceedings.

Opening of composition proceedings has no direct effect on the contracts with the company (unless the very contract provides to the contrary). However, upon the confirmation of a composition agreement with assignment of assets the same rules as for the bankruptcy proceedings are applicable by way of analogy.

5 Claims

5.1 Broadly, how do creditors claim amounts owed to them in each procedure?

Creditors are invited by the bankruptcy administration to file their claims against the bankrupt debtor within a certain deadline (*Schuldenruf/appel aux créanciers*). After expiration of the deadline, claims may still be submitted but the creditor must pay all such costs which have been caused by the delay. Once the deadline for filing the claims has passed, the bankruptcy authority examines the filed claims and makes the necessary inquiries. The debtor is invited to comment on each claim. The bankruptcy authority, which is not bound by the debtor's opinion, decides whether or not to admit the claims. The bankruptcy administration then establishes a schedule of claims (*Kollokationsplan/état de collocation*). Any creditor wishing to contest the schedule of claims because its claim has been entirely or partially rejected or has been admitted in a different class may bring an action against the bankruptcy estate within 20 days of the schedule of claims being made available for public inspection. Similarly, a creditor may bring an action to contest the admission of another creditor to the schedule of claims.

The composition administrator appointed by the court makes a public announcement enjoining the creditors to file their claims. If the composition agreement with assignment of assets is confirmed, the creditors elect liquidators and a committee of creditors to

supervise the proceedings. While the realisation of assets is subject to less strict rules than in bankruptcy proceedings, the distribution of proceeds to creditors follow the same rules as in the case of bankruptcy. The liquidators draw up a schedule of claims without, however, making a further call to the creditors (article 321 par. 1 DEBA). This document will then be made available to the creditors and may be challenged through legal actions to contest the schedule of claims in the same way as in bankruptcy proceedings.

5.2 What is the ranking of claims in each procedure? In particular, do any specific types of claim have preferential status?

Secured claims (*pfandgesicherte Forderungen/créances garanties par gage*) are satisfied directly out of the proceeds from the realisation of the collateral. Should the proceeds not be sufficient to satisfy the claim of the secured creditor, such creditor shall rank with unsecured creditors for the outstanding amount of its claim. Unsecured claims are satisfied in a specific order out of the proceeds of the entire remainder of the bankruptcy estate. There are three classes of claims. The first class consists of claims of employees (i) derived from the employment relationship which arose during the six months prior to the opening of bankruptcy proceedings and which do not exceed the maximum insurable annual salary as defined by the Federal Ordinance on Accident Insurance (which is currently CHF 126,000), (ii) in relation to the restitution of deposited security, and (iii) derived from social compensation plans which arose during the six months prior to the opening of the bankruptcy proceedings. The first class also includes claims of the assured derived from the Federal Statute on Accident Insurance and from facultative pension schemes, as well as claims of pension funds against employers. Finally, claims for maintenance and assistance derived from family law which arose during the six months prior to the opening of bankruptcy proceedings and which are to be performed by cash payments are also comprised in the first class. The second class consists of claims of persons whose assets were entrusted to the debtor as a holder of the parental power, for everything which the debtor owes them in such capacity. This preferential right is only valid provided that the bankruptcy proceedings are opened during the parental administration or within a year of its termination. Claims of various contributions to social insurances are also included in this class. Moreover, as from January 1, 2010 claims of the Swiss Federal Tax Administration for VAT form part of the second class. All other claims are comprised in the third class. Creditors for such claims only get paid after all the privileged claims have been fully covered. Ultimately, claims which have been contractually subordinated will only be paid after the claims of all other creditors have been paid in full.

5.3 Are tax liabilities incurred during each procedure?

As a rule, companies in financial difficulties do not benefit from any special tax treatment under Swiss law. Dissolving hidden reserves or the forgiveness of debt granted by third parties is considered taxable profits. However, a company in financial difficulties has generally incurred losses in previous years that can be set off against these profits. In this context, one must note that Swiss tax law enables set-off with reported losses of the seven prior years. The forgiveness of debt granted by shareholders is, under certain circumstances, treated as a contribution for no remuneration and is subject to an issuance stamp duty of 1%, as is the case with respect to an increase of capital. The same analysis prevails in case of a reduction of the share capital followed by an increase of the

share capital or the contribution for no remuneration. However, in case of a financial restructuring a company may apply for a waiver of issuance stamp duty to the extent that the increase of share capital, the contribution for no remuneration or the forgiveness of debt does not exceed CHF 10,000,000.00 and further provided that such amount covers losses of the company. In addition, even if such threshold is exceeded, a waiver of stamp duty can be obtained if levying such duty would be excessively harsh for the company.

6 Ending the Formal Procedure

6.1 Is there a process for “cramming down” creditors who do not approve proposals put forward in these procedures?

In bankruptcy proceedings, the creditors’ meetings are legally constituted if one quarter of the known creditors is present or represented. The meetings pass and adopt resolutions with the absolute majority of the voting creditors. The second creditors’ meeting may even pass and adopt resolutions by circular resolution.

In composition proceedings the composition agreement must be adopted by a quorum as set forth in question 2.5 above and approved by the court. With the court’s approval, the composition agreement becomes binding upon all creditors of claims subject to the composition agreement whether or not they participated in the composition proceedings and irrespective of their non-approval of the composition agreement.

6.2 What happens at the end of each procedure?

In bankruptcy proceedings following distribution of the proceeds (according to question 3.1 above) the bankruptcy administration submits its final report to the bankruptcy court. If the court finds that the bankruptcy proceedings have been completely carried out, it declares them closed. The company ceases to exist and will be cancelled from the commercial register.

In case of a debt-rescheduling or a dividend agreement, the debtor is not wound-up but rather continues its business, and once such agreement has been adopted by the required quorum of creditors (according to question 2.5 above) and approved by the court, the debtor has again full power to manage the company’s affairs. Only a composition agreement with assignment of assets will ultimately lead to the winding-up and the cancellation of the company from the commercial register.

7 Alternative Forms of Restructuring

7.1 Is it common to achieve a restructuring outside a formal procedure in Switzerland? In what circumstances might this be possible?

The achievement of a successful restructuring outside a formal procedure is not uncommon under Swiss law. It is precisely the purpose of the insolvency tests imposed by article 725 CO to compel the board of directors to adopt measures to improve the financial situation of a company before being obliged to commence formal bankruptcy or composition proceedings. Article 725 par. 1 CO, dealing with the issue of loss of capital (*Kapitalverlust/perde de capital*), obliges the board of directors to convene an extraordinary shareholders’ meeting and to propose appropriate restructuring measures. Article 725 par. 2 CO describes the circumstances under which the board of directors must file for bankruptcy by notifying the situation to the court (see above under question 2.2). That being

said, once notified about the company’s over-indebtedness (*Überschuldung/surendettement*) pursuant to article 725 par. 2 CO, the court may postpone the adjudication of bankruptcy, at the request of the board of directors or a creditor, provided that there is prospect of a financial reorganisation.

7.2 Is it possible to reorganise a debtor rather than realise its assets and business?

The court’s motivation behind a postponement of the adjudication of bankruptcy in accordance with article 725 par. 2 CO is typically to allow for a reorganisation of a debtor rather than for a realisation of its assets within the course of bankruptcy proceedings. Such reorganisation may occur under the supervision of an administrator which is instated by the court.

In addition, there are two forms of composition proceedings which result in a debt restructuring (be it through a debt-rescheduling or a dividend agreement) rather than in a realisation of the debtor’s assets and business. It is fair to say, though, that such forms of composition agreements are rarely used in practice to reorganise large corporate debtors.

7.3 Is it possible to achieve an expedited restructuring of the debtor by means of a pre-packaged sale? How is such a sale effected?

It is possible to transfer the business of the debtor by means of a pre-packaged sale to a newly-established hive-off vehicle or any other third party. In bankruptcy proceedings, such a transfer requires the consent of the bankruptcy administration which is generally bound not to sell the debtor’s assets prior to the second creditors’ meeting (ordinary proceedings) or the expiry date for filing claims (summary proceedings), respectively. According to article 243 par. 2 DEBA, however, a sale may occur prior to such dates if the relevant assets are subject to rapid depreciation, require costly maintenance or cause disproportionately high storage costs. The Swiss Federal Supreme Court has ruled that an expedited sale of the entire business or certain business units of the debtor may be permissible under article 243 par. 2 DEBA. The sale is documented in an asset purchase agreement and may occur pursuant to articles 69 *et seq.* of the Swiss Federal Act on Merger, De-Merger, Conversion and Transfer of Assets and Liabilities. In a moratorium, the sale requires the consent of the composition court according to article 298 par. 2 DEBA. Shares in the hive-off vehicle may further be distributed to the creditors instead of cash proceeds in a composition agreement with assignment of assets.

A sale may also occur outside the scope of insolvency proceedings. However, there is a risk that in a subsequent insolvency proceeding such sale will become subject to challenge based on the avoidance regime in articles 285 *et seq.* DEBA (see question 1.2 above). Notwithstanding the requirement for court approval, the same holds true if the sale occurs during the moratorium.

8 International

8.1 What would be the approach in Switzerland to recognising a procedure started in another jurisdiction?

In bankruptcy matters, Switzerland follows the principle of territoriality. Accordingly, a foreign bankruptcy or any similar proceeding has no effect in Switzerland unless it has been recognised. The recognition of foreign proceedings (*Anerkennung/reconnaissance*) is governed by a special chapter in

the Swiss Private International Law Act (**PILA**). The conditions for the recognition are as follows: (i) the bankruptcy decree must have been rendered in the state of the debtor's domicile; (ii) the petition for recognition may only be introduced by the bankruptcy's administrator or by a creditor, but not by the debtor itself; (iii) the bankruptcy decree must be enforceable in the state where it was rendered; (iv) the bankruptcy must not be inconsistent with the Swiss public policy and the fundamental principles of Swiss procedural law; and (v) reciprocity (*Gegenrecht/reciprocité*) is granted by the state in which the decree was rendered. Pursuant to this latter requirement, the Swiss court must examine if the foreign jurisdiction would also recognise, under similar circumstances, a Swiss decree, at conditions which are not sensibly less favourable than the conditions prevailing under Swiss law for the recognition of a foreign bankruptcy decree. As soon as the petition for recognition has been filed, the court may, on application of the petitioner, order conservatory measures. In principle, once the recognition is granted, the foreign bankruptcy decree has the same

effects as a Swiss bankruptcy decree with regard to the debtor's assets located in Switzerland. The foreign bankruptcy is not extended in Switzerland, but gives rise to an ancillary bankruptcy that can be viewed as a sort of procedure for judicial legal assistance. Moreover, pursuant to article 172 par. 1 PILA, only certain claims may be included in the schedule of admitted debts, i.e. the claims secured by pledged assets which are located in Switzerland according to article 219 par. 1 to 3 DEBA and the unsecured but privileged claims of creditors having their domicile in Switzerland according to article 219 par. 4 DEBA (first and second classes). After the satisfaction of these creditors, any remaining balance is remitted to the foreign bankruptcy estate (article 173 par. 1 PILA). This transfer, which represents the result of the Swiss ancillary bankruptcy, requires, however, the prior recognition of the foreign schedule of claims, whereby the Swiss courts review in particular whether the creditors domiciled in Switzerland were fairly treated in the procedure and were granted an opportunity to be heard.

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