

SWITZERLAND: UPDATE ON SWISS GOVERNMENT MEASURES FOR DEBTORS AND CREDITORS IN CASE OF FINANCIAL DISTRESS RESULTING FROM COVID-19

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1 INTRODUCTION

The recent outbreak of COVID-19 and the public health measures taken by the Swiss government are causing many businesses to face extraordinary challenges, potentially leading to financial distress. Difficulties may arise for a company either because it has trouble, as a creditor, collecting receivables from distressed debtors and/or because it struggles, as a debtor, to discharge its own debts while operating on limited cash flow. The present contribution exposes the duties of distressed companies under normal circumstances (see below **section 2**) before outlining the extraordinary measures ordered by the Swiss government to mitigate the harmful effects of the current COVID-19 financial crisis (see below **section 3**). It then describes options available to companies facing difficulties (see below **section 4**) and possible actions creditors may consider to safeguard their rights (see below **section 5**).

2 WHAT CORPORATE DUTIES KICK IN DURING TIMES OF DISTRESS?

Notwithstanding the extraordinary circumstances, Swiss companies remain bound by the general corporate duties applicable in times of distress, notably in the case of capital loss or over-indebtedness.

Capital loss

If the board of directors has sufficient reasons to believe that half of the share capital and the legal reserves of the company are no longer covered by the net assets (at going concern value), it shall convene an extraordinary shareholders' meeting without delay and propose appropriate restructuring measures (Art. 725(1) of the Swiss Code of Obligations ("SCO")). In this respect, the Swiss government has enacted special rules allowing shareholders' meetings to be held in writing or by electronic means to take

into account social distancing rules induced by the outbreak of COVID-19 (see below **section 3**). Moreover, the implementation of agreed-upon restructuring measures does not require the involvement of a court (see below **section 4**).

Over-indebtedness

Where the board of directors has reasons to believe that the company is not merely in a situation of capital loss but is over-indebted, i.e. the company's assets (whether the assets are appraised at going concern or liquidation value) do not cover its liabilities, the board of directors must prepare an interim balance sheet for a licensed auditor's examination. If the balance sheet confirms the company's over-indebtedness, the board of directors must notify the court accordingly without delay (Art. 725(2) SCO).

There are however two situations where the board of directors does not need to notify the court immediately:

- If certain creditors are willing to **subordinate their claim** to those of all the others in the amount of the capital deficit;
- Where there are **sufficient grounds to expect restructuring**, the board of director may defer the notice to the court for a certain period. There is no absolute rule as regards the acceptable duration of this postponement, which shall in principle not exceed weeks but may exceptionally extend to several months.

Upon receipt of a notice of over-indebtedness from the board of directors, the court automatically declares the company bankrupt, unless the company or its creditors apply for a stay of insolvency or composition proceedings (Art. 725a SCO) (more detail below under **section 4**).

Insolvency

Even without being in a state of capital loss or over-indebtedness, a company may be insolvent, i.e. unable to discharge its debts when they come due, for instance because of a liquidity shortage. Although a situation of insolvency does not oblige the board of directors to consult with the shareholders or to report to the court, it requires directors to be particularly vigilant to avoid civil and/or criminal liability in case the company is eventually declared bankrupt.

Directors' liability when managing a distressed company ending up in bankruptcy

The directors' breach of their obligations resulting from the company's financial distress may have both civil and criminal consequences.

From a civil perspective, directors and other individuals entrusted with the management of a corporation (Art. 754 SCO) or a limited liability company (Art. 827 SCO) shall be personally liable for damages caused by wilful or negligent violation of their obligations. Potential damages notably comprise the additional loss incurred by the company – and borne by its unsatisfied creditor(s) – from the moment the directors knew or should have known of the company's distress and failed to take appropriate measures until the company was declared bankrupt.

Should the company be declared bankrupt, directors may also face criminal sanctions for mismanagement under Art. 165 of the Swiss Criminal Code ("SCrC") or for unduly favouring certain creditors (Art. 167 SCrC).

Against this background, it is crucial that directors constantly monitor the financial situation of a potentially distressed company and, where necessary, timely take the appropriate restructuring measures among those set out in section 4.

3 WHAT EXTRAORDINARY COVID-19-RELATED MEASURES HAVE BEEN IMPLEMENTED TO PREVENT FINANCIAL DISTRESS?

As a response to COVID-19, the Swiss government has gradually ordered a series of extraordinary measures to alleviate the economic burden of COVID-19-related public health measures on Swiss businesses and individuals as follows:

Procedural arrangements

- **Temporary suspension of debt collection actions:** All enforcement actions were suspended from 19 March 2020 to 4 April 2020; the Easter judicial recess (Art. 56(2) Debt Collection and Bankruptcy Act ("DCBA")), which followed immediately, *de facto* extended the

standstill until 19 April 2020.¹ However, creditors could still file, among others, debt collection proceedings to safeguard their rights (see below section 5). On 8 April 2020, the Swiss government confirmed that this suspension period would not be extended after 19 April 2020.

- **Anticipation of Easter judicial recess for civil and administrative proceedings:** The starting point of judicial recess (*fériés/Betreibungsferien*), if existing under the relevant procedural federal or cantonal statute, was exceptionally extended to start on 21 March 2020 and last until 19 April 2020 (inclusive).² This resulted in a standstill of ordinary civil and administrative proceedings during this period. Urgent civil and administrative proceedings as well as criminal proceedings are however unaffected. Moreover, this measure does not toll or suspend limitation periods provided by substantive law.
- **Partial suspension of judiciary measures:** Each canton's judiciary also took extraordinary measures within the framework set by the Swiss government. For instance, the Geneva civil court of first instance cancelled all non-essential hearings until 19 April 2020, after which the court will in its discretion resume convening hearings for urgent matters, notably bankruptcies.³ It also postponed to 25 May 2020 all court-ordered deadlines lapsing on any day until 10 May 2020 save for emergencies and unless provided otherwise by the law. Finally, it temporarily refrained from notifying decisions or judgments (including in urgent matters) and has gradually resumed doing so as from 6 April 2020.
- In order to comply with the social distancing required to slow down the spread of COVID-19, the Swiss government has **dispensed shareholders from physically attending shareholders' meetings** and

¹ Ordonnance sur la suspension des poursuites au sens de l'art. 62 de la loi fédérale sur la poursuite pour dettes et la faillite, available at: <https://www.admin.ch/opc/fr/classified-compilation/20200804/index.html> <30.03.2020>.

² Ordonnance sur la suspension des délais dans les procédures civiles et administratives pour assurer le maintien de la justice en lien avec le coronavirus (COVID-19), available at: <https://www.admin.ch/opc/fr/official-compilation/2020/849.pdf> <30.03.2020>.

³ Public announcement published on the webpage of the Geneva civil court of first instance, available at: <http://ge.ch/justice/tribunal-de-premiere-instance> <30.03.2020>.

has authorized participation either by written/electronic means or by representation.⁴

- **Facilitation of certain procedural requirements:** on 16 April 2020, the Swiss government also took extraordinary measures ensuring the good functioning of justice,⁵ by easing certain formalities such as **conditions for service of debt collection acts**, for the validity of which a strict proof of receipt shall no longer be required. These measures will apply as of 20 April 2020 until 30 September 2020.

Simplified access to liquidity and reduction of liabilities

The Swiss government has adopted measures to enable businesses increase their liquidity and reduce their salary-related liabilities.⁶ In particular:

- It established a **guarantee program** enabling affected small and medium companies (“SMEs”) to obtain bridge loans of up to 10% of their annual turnover (subject to a maximum amount of CHF 20 million) on preferential terms. Loans granted under this guarantee program shall not be taken into account towards the liabilities of the company until 31 March 2022 for purposes of examining situations of capital loss or over-indebtedness (Arts. 725(1) and (2) SCO; see above **section 2**).
- The Swiss government also facilitated access to the **compensation scheme for employers facing a reduced workload** due to COVID-19 and to the resulting entitlement to reduced-working-time indemnities by simplifying the qualifying conditions and procedures. In addition, payment of social security contributions may be postponed and late payment interests on certain taxes is temporarily not applied.

⁴ Ordonnance sur l’octroi de crédits et de cautionnements solidaires à la suite du coronavirus (Ordonnance sur les cautionnements solidaires liés au COVID-19), available at: <https://www.admin.ch/opc/fr/official-compilation/2020/1077.pdf> <30.03.2020>.

⁵ Ordonnance instaurant des mesures en lien avec le coronavirus dans le domaine de la justice et du droit procédural (Ordonnance COVID-10 justice et droit procédural), available at: <https://www.ejpd.admin.ch/dam/data/bj/aktuell/news/2020/2020-04-16/vo-covid19-justiz-f.pdf> <16.04.2020>.

⁶ Ordonnance sur l’octroi de crédits et de cautionnements solidaires à la suite du coronavirus (Ordonnance sur les cautionnements solidaires liés au COVID-19), available at: <https://www.admin.ch/opc/fr/official-compilation/2020/1077.pdf> <30.03.2020>.

Prevention of mass bankruptcies

In addition to the above measures, **on 16 April 2020** the Swiss government also ordered rules aiming specifically at preventing a domino effect of mass bankruptcies by relieving companies from the obligation to report over-indebtedness to the court and/or easing restructuring. These measures will enter into force **on 20 April 2020** for a period of six months at most and include:⁷

- **Suspension of directors' obligations deriving from Art. 725(2) SCO:** no obligation to notify the judge in case of over-indebtedness (see above **section 2**), provided that the company was not over-indebted as at 31 December 2019 and has reasonable prospects of rehabilitation within six months from the end of the extraordinary COVID-19-related measures.
- **Facilitation of composition proceedings**, in particular:
 - (a) exemption of the verification by the judge of the likelihood of reaching a composition agreement or rehabilitation proceedings when granting a moratorium and resulting dispense for the debtor to file a restructuring plan;
 - (b) extension of the temporary moratorium period from four to six months;
 - (c) stay until 31 May 2020 of bankruptcy proceedings which could be ordered by the judge during the composition proceedings under certain conditions, provided the debtor was not over-indebted as of 31 December 2019 or claims in the amount of the capital deficit have been subordinated (Art. 725(2) SCO).
- **Special COVID-19 composition proceedings for small and medium businesses short on cash:** a swift and non-bureaucratic option to obtain a three-month moratorium without the need to file a restructuring plan, provided the debtor was not over-indebted as of 31 December 2019 or claims in the amount of the capital deficit have been

⁷ Ordonnance instaurant des mesures en cas d'insolvabilité pour surmonter la crise du coronavirus (Ordonnance insolvabilité COVID-19), available at: <https://www.ejpd.admin.ch/dam/data/bj/aktuell/news/2020/2020-04-16/vo-covid19-insolvenz-f.pdf> <16.04.2020>.

subordinated (Art. 725(2) SCO). The moratorium may be extended by three months and is characterized by additional restrictions protecting creditors: the moratorium does not cover first ranking claims (such as salaries) or any claims arising after the moratorium is granted.

- **Further measures:** company officers will be held liable should they misuse loans granted under the extraordinary COVID-19 related guarantee program contrary to the statutory purposes. Transfers to third parties made by the debtor with funds received under the extraordinary COVID-19 related guarantee program will be immune from avoidance powers (*actions révocatoires*).

4 WHAT SHOULD SWISS COMPANIES DO IN CASE OF FINANCIAL DISTRESS?

Where financial distress threatens, a company can mitigate harm and perhaps avoid insolvency through targeted restructuring measures, such as private restructuring, composition proceedings, a stay of bankruptcy or COVID-19-related government measures.

Private restructuring

Private restructuring measures include all actions that a company may take outside of insolvency proceedings and which do not interrupt the company's operational activities. Given their contractual nature, they represent a very flexible tool but require the consent of each party involved. They may moreover only be implemented if the law does not require directors or managers to take more incisive actions, such as notifying the court of over-indebtedness (see above **section 2**). The following measures may for instance be contemplated:

- **Corporate restructuring**, organisational and operational measures (increase earnings, decrease liabilities, change in business strategies), accounting measures (release of latent reserves or excessive provisions).
- **Capital adjustment** such as capital increase, capital reduction followed by capital increase and shareholder contributions without consideration.

- **Liquidity increase**, notably by way of obtaining bridge or secured loans, facilitated in the current context as described above at section 3.
- **Subordination or waiver of debt**, standstill agreements, debt-equity swaps, debt-asset swaps, third-party guarantees.

Composition proceedings (Art. 293 ff DCA)

The debtor, any creditor entitled to apply for the debtor's bankruptcy or the bankruptcy court (Art. 293 DCBA) may request a temporary composition moratorium enabling the debtor to (i) take restructuring measures to attain financial rehabilitation or (ii) reach a court-vetted composition agreement with creditors. Such composition agreement provides for the debtor to offer delayed full or (more generally) partial payment of the creditors' claims according to a specific scheme in exchange for a full discharge of debts, thus allowing the debtor to make a fresh start.

Except for hopeless cases, the court immediately grants the requested composition moratorium. The moratorium is made public and a receiver may be appointed by the court to monitor the debtor's activities and facilitate discussions with the creditors. The moratorium interrupts any debt collection proceedings against the debtor (Art. 297(1) DCBA) and prohibits asset-freezing and other conservatory measures in support of the composition claims (Art. 297(3) DCBA). Civil and administrative litigation regarding composition claims, as well as interest, are also suspended (Art. 297(5) and (7) DCBA). The debtor is furthermore entitled to terminate long-term contracts provided that the debtor's rehabilitation would otherwise be compromised (Art. 297a DCBA). The contractual counterparty shall be compensated for any damage suffered therefrom and the resulting claim shall be subject to the composition agreement.

Stay of bankruptcy (Art. 725a SCO)

Where rehabilitation of a distressed company appears possible and no composition proceedings have been initiated or requested, the board of directors or creditors may request the court to stay bankruptcy proceedings (Art. 725a SCO). For the stay to be granted, the debtor must file a restructuring plan, which must be sufficiently detailed and credible.

Unlike composition proceedings, the stay of bankruptcy proceedings under Art. 725a SCO is only available to corporate debtors in situation of over-indebtedness (Art. 725(2) SCO, see above section 2), not in cases of insolvency (i.e. inability to discharge their debts when they come due, usually because of a liquidity shortage). It may be ordered for an indefinite period of time but has no interrupting effect on civil and administrative litigation or on interest. Furthermore, the court may abstain from rendering public its decision on the stay of the bankruptcy proceedings, for the duration of such stay (Art. 725a(3) SCO) to avoid creating panic among creditors. A court-appointed receiver (*curateur*) is tasked with overseeing the business operations to avoid further losses and acts as a watchdog for the court. In dire circumstances, the court may order that no disposal of assets be decided without the receiver's prior approval (Art. 725a(2) SCO).

Given its flexibility, the stay of bankruptcy may present an attractive alternative where the distressed debtor merely wishes to enjoy a short-term moratorium instead of contemplating a composition agreement.

5 WHAT CAN CREDITORS DO NOTWITHSTANDING THE EXTRAORDINARY MEASURES?

While equity dictates that debtors be sheltered from the unforeseeable consequences of COVID-19, creditors should not be left helpless either. As a result, creditors may still use the following tools to protect their claims despite the standstill. In particular, creditors may:

- **Seek conservatory measures from debt collection authorities**, such as inventory orders, surety measures or anticipated liquidation of assets.
- **Initiate debt collection for “*effets de change*”** (i.e. bills of exchange, promissory notes and cheques), which are unaffected by the judicial recess (Art. 56(2) DCBA).
- **Go ahead with criminal proceedings in case of fraud as the prosecution authorities are not barred from freezing the debtor's (or, as the case may be, third parties') assets** on its own initiative or on request from an aggrieved creditor, should a debtor's conduct be suspected of qualifying as criminal offences.

- **Seek freezing injunctions from civil courts** to temporarily secure their debtor's Swiss assets if the ordinary criteria are met.
- **File requests before courts or debt collection authorities as required.** Although the standstill temporarily prevents authorities from acting upon the same, they may work on the files during the suspension with a view to issuing their decision as soon as normal business resumes. Moreover, applying to courts or debt collection authorities tolls limitation periods and hence safeguard creditors' rights.

6 CONCLUSION

The changing times and the uncertainty associated with the rapidly evolving situation pose new challenges for numerous businesses, in their capacity as both creditor and debtor. In these undoubtedly difficult circumstances, timely and appropriate reactions will be key to the continuity of businesses facing the COVID-19 financial crisis.

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