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Switzerland as role model for COVID-19 restructuring / insolvency legislation

On 20 March 2020, the Executive of CERIL – an independent non-profit organization of European lawyers and other restructuring and insolvency practitioners, law professors and insolvency judges – published a statement titled 'COVID-19 urges legislators to adapt insolvency legislation' according to which the emergency legislation in Switzerland is one of the two recommended role models for European insolvency legislators.[1]

Switzerland, more precisely its southernmost Italian-speaking canton (Ticino), borders the epicenter of the European corona virus crisis in Italy (Lombardy) and has therefore been affected quite severely by the pandemic as well. This article briefly describes the Swiss emergency insolvency and restructuring measures which have been adopted to date as a result of COVID-19 (I.) Furthermore, it highlights the reforms which are currently being contemplated and prepared by the Swiss Federal Government and are intended to be introduced shortly after the Easter break (II.).

I. Swiss Legislative Reforms for Companies in Financial Distress to date

1.1 No revision of obligations of directors and managers so far

First of all, it is important to clarify that unlike Germany, Austria, Spain, UK and Australia, Switzerland has so far not yet suspended directors' duties to file for insolvency proceedings based on over-indebtedness. However, it is planned that the Swiss Federal Council will implement such changes through an emergency Ordinance soon after Easter (see Section II. below). Until then, all statutory director duties continue to apply.

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[1] CERIL Executive Statement 2020-1, 'COVID-19 urges legislators to adapt insolvency legislation', 20 March 2020, p. 3 et seq., available at https://www.ceril.eu/news/ceril-statement-2020-1.

1.2 Stay of enforcement

On 18 March 2020, the Swiss Federal Council (SFC)[2] has issued the *Ordinance on the legal standstill in accordance with Article 62 of the Swiss Federal Act on Debt Enforcement and Bankruptcy (DEBA)*[3] *(Legal Standstill Ordinance)*.[4] For the first time since the First World War, the latter provides for a temporary stay of enforcement in relation to all debt enforcement acts against any debtor (both individuals and entities) by debt collection offices, supervisory authorities and bankruptcy courts in the whole territory of Switzerland[5], except for seizure proceedings and other urgent debt collection acts (Art. 62 in conjunction with Art. 56 DEBA). In particular, the forbidden enforcement acts include the service of orders for payment, the removal of debtor's opposition to such orders (granting of 'Rechtsöffnung'), the attachment of assets of the debtor, the liquidation of debtor's assets, the bankruptcy warning and the opening of bankruptcy proceedings. The creditors may still submit debt collection requests but the enforcement authorities will only proceed with them after the end of the standstill.

The Legal Standstill Ordinance was effective from 19 March 2020 until 04 April 2020. Due to the statutory enforcement holidays which last over an extended Easter period that began immediately after that date and have the same effects as the legal standstill, the standstill in fact applies until 19 April 2020. In other words, the SFC's emergency Ordinance basically leads to an extension of the ordinary stay of enforcement from two to four weeks.

However, substantive deadlines – e.g. the statute of limitation according to Art. 127 et seq. *Swiss Code of Obligations (CO)*[6] – are not affected by the legal standstill. Put another way, claims still become payable but the legal standstill only keeps creditors from enforcing them for the time being. Therefore, once the standstill period has expired (i.e. after 19 April 2020), debtors must basically expect to face debt enforcement proceedings or summonses to pay, as claims will continue to fall due during the stay period. In addition, based on Art. 190 DEBA, creditors may then even be able to request the opening of bankruptcy proceedings without prior debt enforcement proceedings provided that the debtor has suspended payments and is objectively illiquid. For this reason, debtors facing financial difficulties should consider timely actions such as the request of a moratorium (see Sections II. 2.1 and 2.2 below) before the end of the standstill.

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2 https://www.admin.ch/gov/de/start/dokumentation/medienmitteilungen.msg-id-78482.html

3 https://www.admin.ch/opc/de/classified-compilation/18890002/index.html

4 Federal Council, Ordinance on the legal standstill in accordance with Article 62 of the Swiss Federal Code on Debt Enforcement and Bankruptcy, SR 281.241, 18 March 2020, available at https://www.admin.ch/opc/de/classified-compilation/20200804/index.html.

5 In the past hundred years since World War I, the legal standstill was only applied for certain limited areas such as the canton of Valais which was severely affected by floods in 1993.

6 https://www.admin.ch/opc/en/classified-compilation/19110009/index.html

II. Pending Reforms of Swiss insolvency and restructuring framework

According to the relevant press release[7], the SFC admits and is aware that the general stay of enforcement as per 1.2 above does not constitute a suitable longer-term instrument for dealing with the economic repercussions caused by the adopted COVID-19 protection measures (particularly the shutdown of restaurants and non-essential shops). The reason for this is threefold: First, it is true that the legal standstill is partly in the interest of the debtors since it allows them to temporarily bridge liquidity shortages but the granted breathing space from creditor actions does not relieve the directors and managers of Swiss companies from their obligation to file for bankruptcy in the event of over-indebtedness. In addition, the measure could harm creditors which as a result of the stay of enforcement face a liquidity crunch themselves. Another disadvantage of the legal standstill is that it drastically reduces the payment morale of the population the longer it remains in place as experienced during the First World War period. Therefore, the Federal Council has ordered the general legal standstill only for a limited time period and anticipated to consider which adjusted measures better allow to protect the various interests at stake.

Against this background, from 01 April 2020 to 03 April 2020, the Swiss Federal Department of Justice[8] opened a public consultation[9] regarding suggested further reforms of the Swiss insolvency legislation which provide for adjustment to the obligations of directors in the event of over-indebtedness (2.1) as well as a new COVID-19-moratorium (2.3) besides certain modifications of the existing composition moratorium(2.2). These measures, which are expected to be introduced by 19 April 2020 at the latest, are outlined in detail below.

2.1 Revision of obligations of directors and managers to file for insolvency

2.1.1 New Proposal

As mentioned, unlike Switzerland's neighbouring countries Germany and Austria, the Swiss emergency legislation has so far not yet suspended or extended the deadline for filing for insolvency as a result of over-indebtedness. The stay of enforcement as per 1.2 above currently only bars creditors from enforcing their money claims. In other words, while bankruptcy proceedings against debtors can't be triggered by creditors for the time being, in case of over-indebtedness there is

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7 https://www.admin.ch/gov/de/start/dokumentation/medienmitteilungen.msg-id-78482.html
8 https://www.bj.admin.ch/bj/de/home/aktuell/coronavirus.html
9 https://www.bj.admin.ch/dam/data/bj/aktuell/coronavirus/oeffentliche-konsultation-d.pdf

still an obligation of the debtor's directors and managers to file for bankruptcy ('depositing the balance sheet') or composition proceedings in Switzerland in accordance with Art. 725 et seq. CO (in conjunction with Art. 820 CO)[10] which have not yet been amended by the emergency orders.

In fact, according to the existing rules, if the last annual balance sheet shows that one-half of the share capital and legal reserves is no longer covered, the board of directors of a Swiss company must convene a general meeting[11] without delay and propose financial restructuring measures (Art. 725 para. 1 CO: capital loss).

Where there is a valid reason for over-indebtedness, an interim balance sheet must be drawn up and submitted to a licensed auditor for examination. If the interim balance sheet shows that the claims of creditors are not covered, whether the assets are appraised at going-concern or liquidation value, the board of directors must notify the court, unless certain company creditors subordinate their claims to those of all other creditors, to the extent of the capital deficit (Art. 725 para. 2 in conjunction with Art. 958a CO: over-indebtedness).

According to Art. 24 of the *COVID-19 Solidarity Guarantee Ordinance*, until 31 March 2022 the government-secured bridge loans for small and medium sized enterprises (SME) as per Art. 3 of said Ordinance are not taken into account as liabilities when calculating the capital loss and over-indebtedness as per Art. 725 CO.

If the board members do not comply with these provisions[12], they may be subject to personal liability (Art. 754 CO) and under certain circumstances even criminal sanctions (e.g. Art. 165 *Swiss Criminal Code*). Since many companies are currently losing revenues as a result of the COVID-19 crisis, there is a high likelihood that these reporting obligations of distressed companies will be triggered in the foreseeable future especially since the company must switch from accounting based on going-concern values to accounting based on (the generally much lower) liquidation values if it no longer appears certain that the company will continue as a going concern for the next 12 months as of the balance sheet date.[13]

In order to mitigate this risk exposure, the SFC contemplates to release a new Ordinance with the following text ('Partial suspension of Art. 725 para. 2 CO') [14]:

> *[1] If the debtor was not over-indebted on 31 December 2019, the notification of the judge in accordance with Art. 725 para. 2 CO is not required if there is a reasonable prospect that an over-indebtedness can be remedied within six months after the end of the measures*

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10 See also Art. 903 CO and Art. 84a Swiss Civil Code.

11 At least Art. 6a of the *Ordinance 2 on Measures to Combat the Coronavirus (COVID-19)* stipulates that such meetings and any other meetings of companies (e.g. AGM) could currently be held through electronic means.

12 The company's auditors have similar reporting obligations (see Art. 725 para. 3, Art. 728c para. 3, Art. 729c CO).

13 Art. 958a CO.

14 https://www.bj.admin.ch/dam/data/bj/aktuell/coronavirus/beilage-2-erlaeuterungen-or-d.pdf. This draft text may be slightly amended based on the results and feedback from the public consultation.

in accordance with Chapter 3 of COVID-19 Ordinance 2 dated 13 March 2020 (SR 818.101.24[15]).

[2] The examination of the interim balance sheet through a licensed auditor pursuant to Art. 725 para. 2 CO is not required.

[3] The paragraphs 1 and 2 mutatis mutandis apply to all legal forms that are subject to a statutory duty of notification in the event of capital loss and over-indebtedness.

2.1.2 Brief Commentary

According to the draft Ordinance, solely the duties of the board of directors[16] to submit the interim balance sheet (respectively two[17] interim balance sheets) to the auditor and to file for bankruptcy if this balance sheet shows an over-indebtedness according to Art. 725 CO are temporarily suspended provided that i) the company was not already over-indebted at the end of 2019 and ii) it can reasonably assumed that the situation of over-indebtedness can be remedied within half a year after the end of the Swiss Federal Government's emergency measures.

However, the statutory obligation to prepare interim balance sheets based on going-concern and liquidation values would remain in force. In other words, on the basis of a comprehensive information analysis, the directors must obtain a clear picture of the economic situation of the company and they are well advised to document the relevant facts and corresponding decisions thoroughly. The necessary remedial forecast serves to protect creditors. If the result of the forecast is negative, the notification obligation is still triggered (unless there is a sufficient subordination agreement in place with creditors[18]). Same applies if the company was already in financial difficulties prior to 2020 i.e. prior to the outbreak of the corona crisis. This is intended to prevent urgently needed reorganisation measures from being delayed any further since such insolvent trading would damage creditors.

For the avoidance of doubt, any other normal director duties also continue to apply, and the new temporary safe harbour rule only applies to the specific insolvent trading liability that might otherwise arise. The suggested new provision together with the already introduced non-consideration of COVID-19 SME loans as debt when determining over-indebtedness provides an incentive for directors to continue trading rather than immediately notifying the bankruptcy court. However, the suspension does not constitute a restructuring solution. It rather provides the directors with more time to come up with such plan.

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15 Ordinance 2 on Measures to Control Coronavirus (COVID-19) (Ordinance 2 COVID-19), SR 818.101.24, modified on 16 March 2020, available at https://www.admin.ch/opc/en/classified-compilation/20200744/index.html

16 In the eyes of the author, the same suspension should also be granted to the auditors.

17 An interim balance sheet in accordance with Art. 725 Para. 2 CO must always be prepared with both going-concern values and liquidation values.

18 In respect of the latter, there is no deviation of the existing law according to the draft proposal.

Apart from this suspension of the obligation to make insolvency filings, the SFC intends to create a new dual moratorium system including the adjustment of the existing composition moratorium (Art. 293 et seqq. DEBA) and the introduction of a new COVID-19-moratorium.

2.2 Amendment of composition moratorium (Art. 293 et seqq. DEBA)

2.2.1 New Proposal

On the basis of a received expert opinion[19], the SFC advocates that subsequent to the end of the general stay of enforcement as per 1.2 above, distressed companies should not be referred to the existing but outdated emergency moratorium in accordance with Art. 337 et seq. DEBA but rather use the more modern instrument of composition proceedings in accordance with Art. 293 et seq. DEBA. In order to make this tool even more suitable and effective for the current crisis situation, the SFC proposes a number of selected amendments to with with the goal to enable viable companies through the assistance of an administrator to be reorganized within a manageable time frame of a few months (in the best case during the provisional moratorium) namely through operational and financial measures as well as concessions of contract parties and creditors. These modifications planned to be enacted through an emergency insolvency Ordinance include the following[20]:

- The further reduction of the already low entry hurdle of Art. 293 and Art. 293a para. 1 and 3 DEBA by basically granting the moratorium to all companies without preconditions provided that they make a request for such composition moratorium and submit a balance sheet, income statement and a liquidity plan or respective documents from which the current and future financial and earnings position of the debtor can be assessed. A preliminary restructuring plan would no longer need to be submitted during the time period in which the COVID-19 measures are in place and the composition courts would no longer be supposed to examine if there is a chance of reorganization or the entering into a composition agreement. Instead, this task shall be done by the administrator during the moratorium proceedings. If not, the administrator requests the opening of bankruptcy proceedings in accordance with Art. 296b DEBA. This change (waiver of examination of the ability to reorganize by the composition court) is also intended to reduce the workload of the composition courts;

- The extension of the (provisional) moratorium pursuant to Art. 293a para. 2 DEBA from today's maximum of four months to six months which would

19 https://www.bj.admin.ch/dam/data/bj/aktuell/coronavirus/beilage-4-gutachten-lorandi-d.pdf

20 https://www.bj.admin.ch/dam/data/bj/aktuell/coronavirus/beilage-3-erlaeuterungen-schkg-d.pdf. Again, the draft text is subject to the final decision of the SFC based on the feedback received.

be in line with the duration limit of the COVID-19-moratorium (see Section 2.3 below);

- The temporary suspension of Art. 296b lit. a DEBA until end of May 2020 provided that the debtor was profitable and not indebted on 31 December 2019 and the financial distress is caused by COVID-19 and the corresponding official combat measures;

- The facilitation of the right of the debtor to extraordinarily terminate continuing obligations during the moratorium. Such termination would temporarily no longer require that the purpose of the reorganization would otherwise be frustrated (Art. 297a DEBA).

Pursuant to the proposal, the amended composition moratorium shall in particular be applicable to the following debtors:

- Companies which were already indebted prior to the COVID-19- Pandemic and prior to the SFC's mitigation measures;
- Listed companies and enterprises of considerable size (see Section 2.3.1 below);
- More complex matters; and
- Companies which would like to obtain the bigger relief granted by the composition moratorium (see Art. 297 para. 7 and 9 DEBA, Art. 297a DEBA, Art. 333b CO) and enter into a composition agreement, respectively.

2.2.2 *Brief Commentary*

The published draft COVID-19 insolvency Ordinance aims to facilitate access to the existing composition moratorium proceedings and to increase the chances of a successful reorganization outcome. However, since the moratorium shall be granted unconditionally upon request, there is a substantial risk that the proceedings will be abused by some debtors which already may have been struggling prior to the outbreak of the COVID-19 crisis.

2.3 New COVID-19-moratorium (SME moratorium)

2.3.1 *Proposal*

In addition to the amendment of the existing composition moratorium as per 2.2 above, the SFC suggests introducing a new simple individual relief mechanism called "COVID-19-moratorium". The new COVID-19-moratorium also planned to be introduced via an emergency insolvency Ordinance consists of several articles and is specifically designed to address the needs of the presumably large number of SME debtors that were previously profitable and not indebted but whose financial distress is caused by COVID-19 and the corresponding combat measures of the government.

According to the draft text of the Ordinance, a debtor that is subject to debt collection under bankruptcy proceedings (Art. 39 DEBA) – in particular all legal entities and sole proprietors registered in the Commercial Registry – can request the composition court to grant a moratorium of no more than three months[21] provided that he was not already indebted on 31 December 2019.[22] Together with the request the debtor shall submit to the court the necessary evidence of his financial position as well as a list of creditors. The COVID-19-moratorium is not available to public companies and companies that exceed two of the following thresholds in two consecutive financial years[23]:

- Balance sheet total of 20 million CHF;
- Turnover of 40 million CHF;
- 250 full-time positions on annual average.

The draft Ordinance explicitly states that directors of the company meet their directors' duties in accordance with Art. 725 para. 2 CO by requesting the COVID-19-moratorium.

In contrast to the composition moratorium (see Art. 293b, 295 DEBA), the COVID-19-moratorium does generally not involve the appointment of an administrator. However, the composition court may at any time appoint an administrator ex officio or upon request of the debtor or a creditor. In such case, the administrator supervises the debtor, can issue instructions to him and supports him in taking the necessary measures and reaching agreements with his creditors. The default state of not appointing an administrator is supposed to take into account the nature of the COVID-19-moratorium as a 'mass transaction' and is intended to keep the administrative workload and cost of the proceedings on a low level.

The approval of the moratorium will be made public by the composition court and it will immediately notify the debt collection office, commercial registry and land registry. Under justified circumstances, the public announcement can be waived upon request provided that the protection of third parties is guaranteed. In that case, the composition court has discretion to decide if an administrator shall be appointed.

21 Upon request, the court may extend the moratorium once for another three months. If the debtor made false statements to the composition court, the latter may ex officio revoke the moratorium at any time.
22 https://www.bj.admin.ch/dam/data/bj/aktuell/coronavirus/beilage-3-erlaeuterungen-schkg-d.pdf
23 However, such companies can obtain relief through the amended composition moratorium as per Section 2.2 above.

All claims against the debtor which arose prior to the granting of the COVID-19-moratorium or up to 30 May 2020 are subject to the relief. This grace period provides the debtor with time to initiate the COVID-19-proceedings. The effects of the granted moratorium largely correspond to those of the ordinary composition moratorium (Art. 297 and Art. 298 DEBA).[24] Particularly, the proposed COVID-19-moratorium only affects claims that arose prior to the grant of the moratorium or up to 30 May 2020. As with the composition moratorium, these claims which are subject to the COVID-19-moratorium are not allowed to be paid by the debtor. If he nevertheless does so, the composition court can open bankruptcy proceedings. Claims that arose after the grant of the COVID-19-moratorium are not affected by it – i.e. can be settled – which allows debtors to continue their business operations as debtors-in-possession. The fact that the debtor pays new debt that is not subject to the COVID-19-moratorium does not constitute legal ground for avoidance and clawback actions pursuant to Art. 285 et seq. DEBA.

In general, the COVID-19-moratorium ends with the passage of time without judicial review.

At any time that is both during and after the COVID-19-moratorium, the debtor may still apply for a provisional composition moratorium as per 2.2 above. In such case, the maximum duration of the provisional composition moratorium will be reduced by half of the time taken by the COVID-19-moratorium.

2.3.2 Brief Commentary

The new COVID-19-moratorium targeting the many SMEs affected by the Swiss Government's COVID-19 response package is supposed to last up to 6 months and offers similar but not as extensive protection as the existing composition moratorium. The goal of the new simplified proceedings is to provide those SMEs which are only in an adverse financial position due to the corona pandemic and which are in a capacity to turnaround within a couple of months with the necessary breathing space without having to resort to the more complex and costly composition proceedings. In fact, there are fewer requirements to seek COVID-19-moratorium protection. In addition, it has been suggested that the Swiss Federal Government shall cover the cost of the court and the administrator, if any is appointed. Furthermore, the SFC plans to provide simple and concise template forms which may be used by SMEs to make a moratorium request to the court.

From an overall economic viewpoint, the effects of the COVID-19-moratorium go less far than a potential extension of the legal standstill as per 1.2 above. First, only those liabilities of eligible debtors which request the COVID-19-moratorium and whose request is granted by the composition court are subject to the stay. Second,

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[24] Especially, with respect to claims which are subject to the moratorium, no debt collection enforcement acts against the debtor can be initiated or continued during the duration of the stay, except for enforcement of a pledge for receivables secured by a real estate lien but the liquidation of the real property is excluded (see also Art. 297 para 1 DEBA). However, unlike Art. 297a DEBA, continuing obligations cannot be terminated by the debtor.

in relation to these debtors only those liabilities are affected which arose prior to the approval of the COVID-19-moratorium and up to the period (30 May 2020) fixed by the SFC, respectively. Hence, the detrimental implications on the general paying moral – where debtors simply cease to pay their bills – is personally and materially limited on the what is absolutely necessary for the distressed debtor affected by COVID-19.

However, the comment made in 2.2.2 with respect to potential abusive moratorium requests also applies in the case at hand although such attempts should in theory be limited by the fact that the COVID-19-moratorium will not be granted if the company was already indebted at the end of 2019. Also, if the debtor made false statements to the court, the court may revoke its granting decision and put the company in bankruptcy liquidation. Last but not least, from a creditors perspective it is also questionable that administrators should generally not be appointed. The emergency Ordinance and the practice will need to prove if Switzerland's insolvency regime deserves the characterization as a European role model. In light of the fact that 99.7% of all companies in Switzerland are SMEs, a lot will come down to whether the Alpine Republic will manage to avoid mass bankruptcy filings of these SMEs during and after this unprecedented crisis.

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