NKF Client News

27 APRIL 2020

Insolvency law aspects in times of COVID-19 (II)

1. Introduction

On 16 April 2020, the Swiss Federal Council enacted the COVID-19 Insolvency Ordinance. It entered into force at 00:00 hours on 20 April 2020. With the COVID-19 Insolvency Ordinance and specific adjustments to Swiss insolvency law, the Swiss Federal Council is seeking to reduce the number of bankruptcies caused by the COVID-19 crisis and the associated loss of jobs. The COVID-19 Insolvency Ordinance introduces several temporary adjustments and changes to the existing Swiss insolvency law and a new COVID-19 moratorium.

2. No extension of the debt collection holidays

The suspension of debt enforcement proceedings enacted as a consequence of the COVID-19 crisis, which expired on 19 April 2020, was not further extended. It is therefore possible to initiate enforcement proceedings against debtors in Switzerland since 20 April 2020 again in the ordinary course, provided the debtor is not in a moratorium, a COVID-19 moratorium or a bankruptcy proceeding.

3. Adjustment of the obligation to notify the court in the event of over-indebtedness under Swiss company law

As explained in our first insolvency newsletter of March 2020, the executive bodies of a Swiss company must notify the court if an audited interim balance sheet shows that the claims of the company's creditors are not covered either at going-concern or liquidation value and it is therefore evidenced that the company is over-indebted. Only (i) if there is a subordination of claims to an extent sufficient to cover the over-indebtedness or (ii) if there are reasonable prospects for a financial restructuring of the company within a reasonable short period of time (generally 4-6 weeks), the notification of the bankruptcy court can be suspended for the time being. Late notification of the court may involve liability risks for the executive bodies. In order to reduce the pressure on the executive bodies of a Swiss company that is over-indebted as a result of the COVID-19 crisis, the Swiss Federal Council has now reduced the requirements for the insolvency filing obligation.

<u>Changes introduced by COVID-19 Insolvency Ordinance (Art. 1 and 2):</u>

First of all, it should be stressed that the obligations of the board of directors under Art. 725 para. 1 and para. 2 of the Swiss Code of Obligations ("**CO**") remain basically unchanged. In particular, the obligations under Art. 725 para. 1 CO remain unchanged in the event of a qualified capital loss. If there are reasonable grounds for concern of over-indebtedness, there is still the obligation to prepare an interim balance sheet at going-concern and liquidation values. However, an audit of the interim balance sheet may now be omitted. The primary change is then that the board of directors must not notify the court in the event of over-indebtedness if:

a) the company was not over-indebted on 31 December 2019 and
b) there are prospects that the over-indebtedness can be remedied by 31 December 2020.

No over-indebtedness as of 31 December *2019*

The decisive factor as regards condition a) is the balance sheet as per end of 2019. Thereby, it is only relevant whether the company was over-indebted as of 31 December 2019 or not. Even if the company was not obliged to notify the court due to over-indebtedness at that time and was allowed to continue its activities due to a sufficient subordination of claims in the amount of the over-indebtedness, the board of directors cannot benefit from the relaxations and is subject to the "ordinary" notification obligations.

This regulation was strongly criticized in the consultation process. The Swiss Federal Council justified it with the argument that only companies that have got into an over-indebtedness situation as a result of the COVID-19 crisis should benefit from the relaxation and that subordination of claims is not a restructuring measure. Start-up companies in particular, where the continuation of operations is often ensured by the instrument of subordination of claims, are likely to be particularly affected by this restriction.

If a company is not able to prove that it was not over-indebted on 31 December 2019 due to a failure to keep books and accounts, it will not be able to make use of the relaxations either.

Positive forecast as per 31 December 2020

On the basis of the most comprehensive information possible, the board of directors must form a view on the economic situation of the company and draw up a "positive forecast" in the interests of the company, according to which there is a prospect that the over-indebtedness can be remedied by 31 December 2020. However, this prospect need no longer be "justified".

If the board of directors decides not to notify the court despite being over-indebted, it must justify and document its decision in writing. This is usually done in the minutes of the board of directors. As supporting documentation for the forecast that over-indebtedness can be remedied by the end of 2020, for example, the interim balance sheet at going-concern and liquidation values as well as documents on financial and liquidity planning can be of assistance.

If the board of directors is not obliged to notify the court based on the COVID-19 Insolvency Ordinance, the same applies to the company's auditors who have a similar obligation.

Beside applicable to stock corporations, these changes apply *mutatis mutandis* to all other entities that are subject to a statutory obligation to notify the court in the event of capital loss and over-indebtedness (in particular also the limited liability company (*GmbH*), cooperative and foundation). However, financial service providers that are subject to a special insolvency regime under special law (in particular in the area of banking or collective investment law) and for which the obligations under company law pursuant to Art. 725 CO (and similar provisions for limited liability company (*GmbH*), cooperatives and foundations) are not applicable under the special legal provisions will not benefit from the relaxations.

4. Adjustments to the existing law on moratorium proceedings

The moratorium proceedings are governed by Art. 293 et seq. of the Debt Enforcement and Bankruptcy Law ("**DEBL**") and consists primarily of a provisional (Art. 293a et seq. DEBL) and a definitive moratorium (Art. 294 et seq. DEBL). Despite the introduction of a new COVID-19 moratorium (see below), these two moratorium proceedings are still relevant because the COVID-19 moratorium is not available to, *inter alia*, listed and/or large companies. In addition, the debtor can opt for one of these "ordinary" moratorium proceedings if certain legal consequences are necessary which are only available under these " ordinary" moratorium proceedings, e.g. if (i) first-class claims shall also be subject to the moratorium, (ii) legal proceedings shall be suspended or (iii) contracts with continuing obligations (*Dauerschuldverhältnisse*) shall be terminated, and (iv) whenever the conclusion of a composition agreement is the aim of the moratorium.

Changes introduced by COVID-19 Insolvency Ordinance (Art. 3-5):

The COVID-19 Insolvency Ordinance facilitates access to a provisional moratorium by not requiring that the debtor's application for the opening of a moratorium proceeding be accompanied by a provisional restructuring plan. This also eliminates the need for the moratorium court to examine the debtor's ability to restructure. This makes the moratorium proceeding more cost-effective and thus more accessible for small and medium-sized enterprises. It is also expected to further accelerate the proceedings. Correspondingly, the principle that the moratorium court will declare bankruptcy *ex officio* if there is obviously no prospect of restructuring or confirmation of a composition agreement at the time of applying for a moratorium (Art. 293a DEBL) will not apply. The provisional moratorium may now last up to six months (previously four months).

Until 31 May 2020, the rules pursuant to Art. 296b lit. a and b DEBL, according to which bankruptcy will be officially opened before the end of the moratorium proceeding, if:

a) this is necessary to preserve the debtor's assets; or
b) there appears to be no longer any prospect of restructuring or confirmation of a composition agreement.

However, this only applies if the debtor was not over-indebted on 31 December 2019 or if claims were subordinated within the meaning of Art. 725 para. 2 CO in the amount of the over-indebtedness at such time. With the introduction of a stay period until 31 May 2020, the debtor is given additional time to prepare the restructuring. Otherwise, due to the COVID 19 crisis, in many cases the debt-restructuring moratorium would presumably have to be terminated immediately and bankruptcy would have to be opened. However, the administrator, who is usually appointed in "ordinary" moratorium proceedings, remains obliged to review the prospects of restructuring after the expiry of the stay period until 31 May 2020. If then the restructuring no longer appears feasible, the administrator needs to notify the court so that it can open bankruptcy proceedings on the basis of the these provisions if the restructuring measures have not produced the desired effects by then.

5. New "COVID-19 moratorium" (COVID-19 Insolvency Ordinance)

The COVID-19 Insolvency Ordinance introduces a new "COVID-19 moratorium". This instrument is intended to provide financially troubled debtors with a simple procedure to obtain a temporary moratorium in order to reorganize for the duration of the moratorium and prepare for the time after the COVID-19 crisis. The new "COVID-19 moratorium" is similar to a provisional moratorium proceeding with additional relaxations, which makes the instrument available to eligible debtors with very limited preconditions.

5.1 Initiation of the "COVID-19 moratorium"

Any debtor in the legal form of a sole proprietorship, partnership or legal entity can apply to the court for a COVID-19 moratorium with a maximum term of three months if the debtor was not over-indebted on 31 December 2019 or if claims were subordinated in the amount of the over-indebtedness in accordance with Art. 725 Para. 2 of the Swiss Code of Obligations.

The COVID-19 moratorium is not available to the following legal entities:

— companies that (a) have equity securities listed on a stock exchange, (b) have bonds outstanding, or (c) contribute at least 20 percent of the assets or turnover to the consolidated group financial statements of a company pursuant to letter a) or b);

— companies that have exceeded two of the following thresholds in 2019: (a) total assets of CHF 20 million, (b) turnover of CHF 40 million or (c) 250 full-time equivalent employees on an annual average.

With the application for a COVID 19 moratorium, the debtor must credibly demonstrate his financial situation and document it as much as possible.

5.2 Extension and revocation of the "COVID-19 moratorium"

The COVID-19 moratorium may be extended for a maximum of three additional months. If the debtor has made false statements to the court, the latter may revoke the COVID-19 moratorium *ex officio* at any time.

5.3 Court appointed administrator and its powers

The COVID-19 moratorium does normally not come with the appointment of an administrator. Only in qualified cases, such as those involving larger companies or complicated circumstances, the court may appoint an administrator at the request of the debtor, a creditor or *ex officio*, irrespective of the status of the proceedings.

5.4 Publication and notification of the "COVID-19 moratorium"

The approval and the extension of the COVID-19 moratorium will be made public by the court and also brought to the attention of the debt enforcement registry, commercial registry, and land registry without delay. The debtor must further immediately inform all known creditors about the approval and, if applicable, the extension of the COVID-19 moratorium in writing or by e-mail.

5.5 Effects of the "COVID-19 moratorium"

All claims against the debtor that came into existence before the moratorium was granted are subject to the COVID-19 moratorium. The COVID-19 moratorium does not apply to first class receivables (in particular wage and alimony claims) and certain claims in connection with social security.

The debtor is prohibited to pay claims that are subject to the COVID-19 moratorium. Otherwise, the court may open a bankruptcy proceeding over the debtor *ex officio*. On the other hand, once the COVID-19 moratorium has been granted, the debtor may enter into new obligations and pay the corresponding claims. This is to enable the debtor to continue its business (see also 5.6 below).

The effects of the COVID-19 moratorium largely correspond to those of the ordinary moratorium proceeding (Art. 297 and 298 DEBL). In particular:

a) during the COVID-19 moratorium, debt collection against the debtor for claims covered by the COVID-19 moratorium can neither be initiated nor continued – with the exception of debt collection by way of realization of a pledge for claims secured by a real estate lien; however, realization of the real estate lien is excluded;
b) Article 199 para. 2 DEBL applies analogously to pledged assets;
c) seizure of assets (*Arrest*) and other security measures for claims subject to COVID-19 moratorium are excluded;
d) an assignment of future claims agreed prior to the granting of COVID-19 moratorium is rendered ineffective for claims, which only come into existence after the granting of COVID 19-moratorium;
e) the periods of limitation and forfeiture are suspended for claims which are subject to COVID-19 moratorium.

f) Art. 213 and 214 DEBL shall apply to set-off - the approval of the COVID-19 moratorium replaces the opening of bankruptcy proceedings as the relevant point in time;
g) for claims ranked in the first class, which are not subject to COVID-19 moratorium, only enforcement by seizure or realization of assets is possible.

As mentioned above, an assignment of future claims agreed before the granting of the COVID-19 moratorium is deemed invalid for those claims that only come into existence after the granting of the COVID-19 moratorium. This provision may prove to be problematic in practice, especially in the present crisis situation, and may cause additional complications. For example, factoring - a central means of liquidity planning for many SMEs - functions via global assignments regarding future receivables. If an SME, which has a factoring-solution in place, applies for COVID-19 moratorium, receivables must then be individually assigned to the factoring company in order to fulfil the receivables purchase agreements. In practice, this requires at least a written declaration of assignment. The same applies if bank loans are secured by global assignments of receivables.

In contrast to the ordinary moratorium proceeding:

a) during the COVID-19 moratorium, the interest on all claims continues to accrue;
b) contracts with continuing obligations (*Dauerschuldverhältnisse*) cannot be terminated extraordinarily; and
c) civil law proceedings and administrative proceedings concerning claims covered by the COVID-19 moratorium will not be suspended.

5.6 Debtor's authority to dispose of assets during COVID-19 moratorium

The debtor can continue its business activities, in particular enter into new obligations and pay according liabilities. On the other hand, for the duration of the COVID-19 moratorium, the debtor may not perform any legal acts which prejudice the legitimate interests of creditors or favor individual creditors to the detriment of others.

Without the authorization of the court, the debtor may also no longer (i) sell, (ii) encumber, or (iii) pledge parts of the noncurrent assets in a legally valid manner during the COVID-19 moratorium. If the court has granted such authorization, the debtor's according legal actions are not subject to avoidance actions.

If, exceptionally, the court has appointed an administrator, it may:

a) order that certain acts of the debtor may only be validly performed in cooperation with the administrator; or
b) authorize the administrator to take over the management of the business for the debtor.

Rights of third parties acting in good faith are protected.

If the debtor acts contrary to these provisions or contrary to the instructions of an administrator, the court may revoke his authority to dispose over his assets or declare bankruptcy over the debtor *ex offico*. The court may also declare bankruptcy over the debtor *ex officio* if this is necessary to preserve the debtor's assets.

5.7 Treatment of newly entered liabilities in a subsequent bankruptcy or composition agreement with assignment of assets

If an administrator has been appointed and the debtor enters into new obligations with the administrators' consent during the COVID-19 moratorium, these liabilities will bind the bankruptcy estate in subsequent bankruptcy proceedings or in a composition agreement with assignment of assets and as such benefit from certain preference. The same applies to claims of a contractual party of a contract with continuing obligations (*Dauerschuldverhältnisse*) that continued to being performed with the consent of the administrator. Contrarily, new liabilities entered into without the consent of an administrator will not be privileged in a subsequent bankruptcy procedure or in a composition agreement with assignment of assets (which should be the rule in the context of a COVID 19 deferral).

5.8 Change to "ordinary" moratorium proceedings during COVID-19 moratorium

A debtor may apply for an "ordinary" provisional moratorium at any time during the COVID-19 moratorium. If the application is granted, the debtor switches to the "ordinary" moratorium procedure. The allowed maximum duration of the provisional moratorium is then reduced by half of the already expired duration of the COVID-19 moratorium.

6. Summary

In summary, the Swiss Federal Council, in order to prevent a surge of bankruptcies caused by the COVID-19 crisis and the corresponding negative economic consequences, has decided to take the following measures:

a) companies are exempt from the obligation to notify the court in the case of COVID-19-related over-indebtedness under certain conditions;
b) the existing moratorium proceedings under the Swiss insolvency law are made more cost-effective and thus more accessible to SMEs by abolishing the court's requirement to examine the chances of successful restructuring and by abolishing the related documentation obligation;
c) the *ex officio* opening of a bankruptcy proceeding during an ongoing moratorium proceedings is being restricted under certain conditions until 31 May 2020 (the chances of successful restructuring will be examined by the administrator after expiry of the stay period until 31 May 2020; if the prospects for successful restructuring are negative or if it is necessary to preserve the debtor's assets, bankruptcy procedures will be opened then);
d) introducing a new COVID-19 moratorium aimed to support small and medium-sized enterprises as a modern and more restructuring-friendly version of the emergency moratorium.

If you have further questions or comments on this topic, please reach out to your regular NKF contact.

Authors /Contact

Thomas Sprecher	Marco Häusermann	Roman Sturzenegger
Partner	Partner	Senior Associate
thomas.sprecher@nkf.ch	marco.haeusermann@nkf.ch	roman.sturzenegger@nkf.ch