CORPORATE FINANCE/M&A - SWITZERLAND

Corporate and financial reorganisation: an overview

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AUTHORS

Alexander Vogel

Christian Rebell

Introduction

It has become increasingly clear that after the initial shock caused by the COVID-19 lockdowns, businesses will face lasting challenges, including disrupted supply chains, declining demand and increased financing costs. Against this background, a growing number of investors will need to assess how to deal with distressed business units or entire companies. This article provides an overview of corporate and financial reorganisation options, particularly with regard to the sale of distressed companies or business units and carve-out transactions.

Reorganisation methods

Swiss law provides for a series of reorganisation options. The main alternatives can be summarised as follows:

Sale
Disposing of an entire company or its unprofitable operations is often the most straightforward reorganisation method. However, a distressed sale also confronts the parties with specific challenges. In particular, carve-out transactions can raise complex legal, tax and operational issues.

Corporate reorganisation
Swiss corporate law provides for series of instruments to reorganise a distressed company. Beside debt-equity swaps and other classical capital measures (eg, capital increases), the so-called 'harmonica' is an instrument often used to restore the statutory required equity base of a company. This instrument allows reducing the share capital to zero (and to offset losses in the amount of the share capital and thereby removing them from the balance sheet) and to issue new shares against fresh capital immediately thereafter.

Financial reorganisation
Measures to reorganise debt include:

- reducing interest rates;
- extending repayment terms;
- (partial) debt waivers;
- the granting of additional security (for further details please see "Granting of security interests in Switzerland"); and
- refinancing by more risk-affine creditors.

In Switzerland, a growing number of investors provides mezzanine financing to small and medium-sized enterprises in such situations. Equity holders are often required to subordinate their shareholder loans, which as a result become, from an economic point of view, a particular asset class and are repayable only once all third-party debt is fully covered by assets.

Composition agreements
The Swiss composition agreement is often assimilated to the Chapter 11 proceeding in the United States. It aims to avoid bankruptcies and allow businesses to recover instead. Composition agreements require the approval of the competent court and the consent of a certain creditor majority. Composition agreements allow the debtor to settle its debts in a way which is binding to all creditors. The creditors usually waive a certain percentage of their claims.

Bankruptcy and liquidation
If there is no realistic reorganisation scenario, shareholders and creditors have usually a shared interest to avoid official bankruptcy proceedings and run self-administrated liquidation proceedings instead.

The choice of the reorganisation method depends on many factors. Tax considerations play an important role, as do the interests of the shareholders and creditors and the viability of the sold (and of the remaining) business operations. Specific rules may apply for listed companies (for further details please see "Restructuring exemption in Swiss takeover law").

This article focuses on the first option and presents selected points to be considered in the sale of a distressed company or business unit.

Sale of distressed companies

Selling the shares of distressed companies usually imposes severe time constraints on both the seller and the acquirer, but also on the creditors. Precise project management and an excellent coordination between the parties are vital.

The valuation of a distressed enterprise also raises particular challenges. Earnings before interest, taxes, depreciation and amortisation (EBITDA) multiples are probably the most frequently used valuation method in Swiss M&A deals. However, the definition of the relevant EBITDA can be challenging in a crisis: past values provide no reliable basis for a valuation and, for a distressed business, a future EBITDA is even more than in normal circumstances highly uncertain.

An appropriate valuation is important not only for financial reasons, but also for legal reasons. In a distressed situation, the buyer must assess whether the corporate seller may itself face an insolvency risk. In the event of a bankruptcy, the receivership or the sellers' creditors may try to challenge the sale or aim at obtaining financial compensation on the grounds that the bankrupt seller did not collect an adequate compensation for the sold business. These risks are mitigated if the purchaser can document that the purchase price satisfies the arm's-length criterion (eg, with a fairness opinion).

Distressed carve-out transactions

Reasons for carve-out transactions
Carve-out transactions are chosen for various reasons. In a distressed situation, the seller may have to focus on its core activities or realise cash from non-essential assets. The buyer in turn may want to assume only operations which allow the realisation of synergies with its own organisation.

Another motive can be the segregation of certain liabilities or contractual relationships with restrictive covenants, which the buyer does not want to assume (eg, a technology licence agreement, which also obligates the licensee to have its products exclusively assembled by the licensor).

Structuring alternatives
Carve-out transactions can be structured in several ways. The most straightforward way is often an asset deal, where the relevant assets, liabilities, contracts and employees are transferred directly to the buyer.

Other structuring variants include the incorporation of a fresh company to which the seller transfers the relevant assets. The buyer subsequently purchases the equity in the new entity. Although rare in practice, Swiss law also offers the possibility of a statutory de-merger. The buyer will, again, purchase the shares in the spun-off company.

An asset deal can be implemented by:

- individual transfers; or
- a bulk transfer.

In the first case, the legal provisions applicable to the transfer of each relevant asset, liability or contract must be complied with. In particular, assets or a surrogate thereof (eg, the key of a car) must be handed over physically and contracting partners must consent to the transfer of their contractual relationships. The bulk transfer in turn provides for a transfer *uno actu* of all items listed in the bulk transfer agreement, particularly of contractual arrangements (ie, with few exceptions, individual formal requirements need not be complied with or must be complied with only at a later stage, such as, for real estate, the inscription of the new owner in the land registry). As a bulk transfer agreement can be ordered by anyone from the Swiss commercial registry (where it must be filed), it is important to evaluate how many details of the transferring business and the purchase price must be provided for (in a non-aggregate form) in such agreement (and in what granularity), since the information provided for in the agreement cannot be kept confidential (for further details please see

"Bulk transfers").

Selected topics to be considered in distressed asset deals

With regard to the asset deal as such (whether constituting the transaction with the acquirer or a preparatory step before a share deal), several points must be considered in addition to those mentioned above for distressed share deals.

First, the employees pertaining to the transferring business transfer to the purchaser by law. The parties cannot exclude this transfer. Employees must be informed about the implications of the transaction in any case. If measures such as dismissals or (to the extent allowed) extended working time are planned which affect employees directly, they must also be formally consulted. In a restricting context, the parties must consider that even terminated employment relationships transfer to the purchaser. The costs of the reorganisation measures (eg, employee consultation and wages for the terminated but nonetheless assumed employment relationships) must be allocated between the parties.

Second, sellers keen not to assume liabilities must consider that under Swiss law, certain liabilities transfer to the acquirer by operation of law – even in an asset deal. This can for instance be the case for both direct and indirect tax liabilities. If in the course of the due diligence, buyers identified such liabilities, they will usually insist on including an indemnity in the acquisition agreement.

However, in a distressed transaction, the seller may be unable to satisfy indemnity claims. Thus, purchasers are well advised to require additional security. However, in a distressed situation, assets or cash-flow streams which could serve as a security are sometimes unavailable. If the group of the seller as a whole faces financial difficulties, a corporate guarantee from another affiliate may not provide the required assurance, either. Thus, buyers may want to consider:

- an escrow solution;
- a warranty and indemnity insurance; or
- lowering the purchase price.

For further information on this topic please contact Alexander Vogel or Christian Rebell at Meyerlustenberger Lachenal by telephone (+41 44 396 91 91) or email (alexander.vogel@mll-legal.com or christian.rebell@mll-legal.com). The Meyerlustenberger Lachenal website can be accessed at www.mll-legal.com.