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Debt Restructuring and Bankruptcy Proceedings under Swiss Law: When the Court Decides in the Company's or Creditors' Stead

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1. Introduction

Swiss law knows two types of court supervised proceedings to deal with a company in financial distress: the bankruptcy proceedings and the debt restructuring proceedings.

The company in financial distress often has to have a look at its options and decide which one of both options is in its best interests and the best interests of its creditors. Both proceedings have different purposes and that is why the decision should not be taken hastily. In some cases, the court can take the decision in the company's or creditors' stead if the company has filed a request with the court which does not reflect the company's financial situation and the company's financial future perspective.

First we will give a brief overview of the purpose and the opening procedure of the bankruptcy proceedings and the debt restructuring. Secondly, we will present two recent decisions rendered by the Swiss Federal Supreme Court which illustrate the difficulties a company can face to meet the conditions of debt restructuring proceedings.

2. Brief overview on the purposes of the proceedings and the opening procedure

2.1 Bankruptcy proceedings

Bankruptcy proceedings have only one purpose: to liquidate the company's assets and distribute the proceeds thereof in accordance with rules pre-established in the Swiss Debt Collection and Bankruptcy Act.

An over indebted or illiquid company can request the opening of the bankruptcy proceedings with the competent bankruptcy court. Beside some exceptions where bankruptcy proceedings can be requested without any preliminary proceedings, a creditor can make such a request if he or she has an enforceable payment order against the company and has requested the pursuance of the enforcement proceedings. If the conditions are met, the bankruptcy court issues a judgement and officially notes the date and time of the opening of the bankruptcy proceedings.

After court's judgment, the company ceases its activities and the liquidator takes over the command of the company in liquidation with the only purpose to liquidate it (no going concern). The task of the liquidator is mainly limited to the establishment of a list of assets and a list of creditors and to the liquidation of the assets by organising public auctions or – under certain conditions – private sales.

2.2 Debt restructuring proceedings

Debt restructuring proceedings can consist in entering into a composition agreement in which the situation and destiny of the company and of the company's debts is determined. Debt restructuring proceedings can also consist in single measures which enable the company to regain financial health within a certain period of time without the need of a composition agreement.

If a composition agreement can be found, the debt restructuring proceedings follow two distinct and mutually exclusive purposes.

Indeed, the composition agreement can aim:

- either to liquidate the company in a more flexible way compared to the bankruptcy proceedings (which is the case of the Swissair debt restricting proceedings), e.g. by trying to find the most suitable solution to sell the assets of the company to the highest price possible without a public auction; or
- to allow the company to pursue its activities past the debt restructuring proceedings by rearranging, settling and negotiating the company's debts; in this case, the creditors agree to renounce to a part of their claims which is documented in the composition agreement and becomes binding upon all company's creditors.

It is to be noted that the fist purpose/option can be quite advantageous for the creditors when the company has valuable assets, as –in most cases – the creditors receive a higher dividend than in bankruptcy proceedings. The second purpose/option is interesting – and the only way for the company to survive – when a company believes

that it has prospects to recover a financially viable situation following the debt restructuring measures.

The debt restructuring proceedings are introduced by a creditor of the company's request. Beside the company itself, a creditor that can request the opening of bankruptcy proceedings is also entitled to request the court to grant a temporary composition moratorium as an alternative to bankruptcy proceedings. The debt restructuring court will reject the temporary composition moratorium request if it is obvious that there is no prospect for a restructuring (with or without a composition agreement with the creditors); in case of rejection of the request, the court – by law – has to directly and automatically open bankruptcy proceedings over the company and the company will be liquidated as described above.

In the event the court finds that a prospect for a restructuring measure cannot be excluded and grants the temporary composition moratorium, the court will appoint a temporary trustee that will be in charge of the restructuring proceedings. The trustee will then take the first measures to identify the assets and debts of the company and monitor the company's actions. The maximal duration of a temporary composition moratorium is four months. The law does not provide for the right to appeal against the decision to grant the temporary composition moratorium and to appoint the trustee.

If the debt restructuring court finds during the temporary composition proceedings that there is prospect for debt restructuring or a composition agreement, it will convene an oral hearing and can grant a final composition moratorium for an additional four to six months. The company and if applicable the creditor that requested the composition moratorium have to be invited to the hearing. However, in the event the debt restructuring court assesses that there is no prospect for a debt restructuring or a composition agreement, the court will directly and automatically open the bankruptcy proceedings over the company and the company will be liquidated.

3. Revocation of temporary composition moratorium

3.1 Facts and decision

In a decision of 11 November 2016,[1] the Swiss Federal Supreme Court upheld a decision of the first instance district court in which the revocation of the temporary composition moratorium was ordered.

The first instance district court considered that the company had no prospect of a restructuring and decided – before the moratorium period elapsed – to revoke the temporary composition moratorium that had been previously granted. This lead to the automatic opening of the bankruptcy proceedings over the company.

The company appealed against this decision. The cantonal court of appeal upheld the decision of the first instance district court and rejected the company's appeal. The company filed an appeal with the Swiss Federal Supreme Court.

3.2 Merits

The company argued that the cantonal court of appeal breached on several occasions the applicable procedural rules. The Swiss Federal Supreme Court rejected all of these formal arguments.

The Swiss Federal Supreme Court considered that the true ground of this appeal was the fact that the bankruptcy proceedings were opened before the expiry of the temporary composition moratorium period. In this context, it held that the decision whether to grant a final composition moratorium has to be taken before the end of the duration of the temporary composition moratorium. Therefore, the district court was entitled to use its discretional power to set the court hearing date two weeks prior to the end of the temporary composition moratorium.

Also, the Swiss Federal Supreme Court considered and confirmed that the company – which merely asserted many times during the temporary composition moratorium that it would soon receive funds for a restructuring without giving any evidence for it – had been unable to prove the prospects of debt restructuring. Consequently, the Swiss Federal Supreme Court found that the court of first instance did not violate any rights of the company by setting a court hearing date two weeks prior to the end of the temporary composition moratorium.

In conclusion, the Swiss Federal Supreme Court found that the opening of the bankruptcy proceedings was correct and lawful and rejected the appeal of the company.

4. Appeal against final composition moratorium

4.1 Facts and decision

In another case that went up to the Swiss Federal Supreme Court, the auditor of a company informed the judge of first instance about the company's over-indebtedness.

In parallel, a creditor requested with the debt restructuring court to grant a temporary composition moratorium.

Notes

1 Decision 5A_495/2016, available on www.bger.ch (in German).

The judge of first instance decided to stay the proceedings until the decision of the debt restructuring court would be issued. The debt restructuring court then granted the temporary composition moratorium and appointed a trustee.

Later on, the debt restructuring court deemed that there was no prospect for debt restructuring or moratorium agreement and it revoked the temporary composition moratorium and opened bankruptcy proceedings over the company.

The company appealed against this decision but the court of appeal rejected the appeal. The Federal Supreme Court finally confirmed the first instance decision by decision of 29 September 2016.[2]

4.2 Merits

In its appeal against the decision concerning the opening of bankruptcy proceedings, the company first tried to criticize how the cantonal court established the facts; however, the Federal Supreme Court rejected this argument.

On the merits, the company argued that the conditions for the creditor to request a temporary composition moratorium were not met in the first place; therefore, the subsequent decision to revoke the temporary composition moratorium and to order automatically the opening of bankruptcy proceedings was not justified. The court of appeal did not follow the company's argument and held that the company was no longer entitled to challenge the creditor's right to request a temporary composition moratorium at this stage of the procedure (appeal against the opening of bankruptcy proceedings). The Swiss Federal Supreme Court did not share the appeal court's view and deemed that a company is entitled to challenge the creditor's right to request a temporary composition moratorium in an appeal against the opening of the bankruptcy as the company did not have the right to appeal the decision to grant the temporary composition moratorium.

However, this finding did not help the company to win the case as the Swiss Federal Supreme Court held on the merits that the company failed to prove that the creditor who initiated the composition moratorium proceedings in the first place did not have the right to do so.

In the end, the Swiss Federal Supreme Court rejected the company's appeal because it deemed that the company had no prospect of restructuring and that the opening of the bankruptcy proceedings was justified. In particular, the Swiss Federal Supreme Court noted that the company had not even filed an audited balance sheet.

5. Conclusion

The recent case law on debt restructuring proceedings illustrates that the company or the creditors requesting to open a formal restructuring proceeding have to be sure that there is a prospect for debt restructuring and that there is evidence to prove this.

Even though the debt restructuring proceedings may be a good solution to restructure a company, a creditor or a company may be better advised to wait until the financial prospects of the company are more clearly defined as any premature request bears the risk that the debt restructuring court finds that there is no prospect of restructuring which can finally lead to bankruptcy.

Therefore, if the company has a real chance to continue pursuing its commercial activity, it is recommended to collect all evidence proving the prospect of debt restructuring before initiating these court proceedings.

Notes

2 Decision 5A_950/2015, available on www.bger.ch (in French).