The gradual coming of age of Swiss distressed M&A

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explore how positive procedural changes in Switzerland have improved bankruptcy-related scenarios for businesses and creditors

In 2014, Swiss bankruptcy law was updated to improve the ability of companies to restructure. These revisions expanded the toolbox available to distressed M&A practitioners and generated helpful case law.

In light of these recent developments, this article gives a snapshot of key considerations in the structuring of the sale and acquisition of distressed assets in Switzerland.

Out-of-court transactions

As a company teeters on the verge of financial distress, it may envisage the disposal of assets to raise cash and forestall bankruptcy. Yet, such out-of-court transactions by a company in distress are inherently risky for the seller's directors and the purchaser alike.

Typical structure

In scenarios where it is not the target that is put up for sale in a share deal with all liabilities attaching to the business, the transaction will be structured as an asset deal.

An asset deal enables the purchaser to pick the assets and contracts that it wishes to acquire. The purchaser may also assume specified liabilities.

A variant of an asset deal is the 'hive-down' in which the assets, liabilities and contracts to be taken over are first dropped down into a newly formed subsidiary. The seller then transfers the shares in the subsidiary to the purchaser.

Risk of challenge

Whether structured as a straight asset deal or a hive-down, an out-of-court asset deal by a distressed seller exposes the purchaser to the risk of challenge.

Specifically, if the seller were to become bankrupt during the 12-month period following the asset sale, the transaction could be avoided if it was made at an undervalue.

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In addition, a 'credit bid', i.e. a sale in which a purchaser-creditor uses a claim as consideration to purchase assets from the seller-debtor, would be subject to challenge in a subsequent bankruptcy happening within a 12-month period if the transaction occurred while the seller-debtor was over-levered.

The recovery or hardening period is extended to five years if the asset sale occurred with the actual intent (recognisable by the purchaser) to harm the seller's creditors or favour certain creditors of the seller over others.

If the risk crystallises and the transaction is avoided, the bankruptcy estate will be restored in its ownership of the assets previously divested while the buyer's claim to recover the purchase price would be classified as an unsecured (pre-petition) claim in the bankruptcy – an exceedingly unfavourable outcome for the purchaser.

Purchaser's additional risks

While the purchaser will seek to cherry pick the assets, liabilities and contracts, Switzerland has its own version of 'transfer of an undertaking regulation' or TUPE. These rules provide that if the asset sale comes down to the transfer of a business or part thereof, employment contracts and related claims will automatically transfer to the purchaser, unless the employee objects to the transfer. This may in effect defeat the purposes of an asset sale.

In addition, there may be little credit behind post-closing claims for breaches of representations and warranties or indemnity claims. Accordingly, the purchaser often will need to look for an escrow, a holdback or warranty and indemnity (W&I) insurance.

Key risks for the seller's board of directors and management

In a distressed asset sale, the directors and management of the seller must ensure they satisfy their fiduciary duties or else be exposed to personal liability claims in a potential subsequent bankruptcy.

Specifically, the board must act to obtain the best available price. In this connection, the board must design a reasonable sale process, which will usually involve an active market check. The board must also seek specialist advice, a key underpinning to the board's acting reasonably in the circumstances.

Time pressure

Intense time pressure is part and parcel of out-of-court distressed transactions. This is not only a business imperative to raise cash and maintain the company's standing with clients and suppliers. Key parties in interest, such as the seller's board, management and auditors, will also want a transaction to happen in a short timeframe as they may otherwise be duty bound to notify the bankruptcy court (or be personally liable for 'wrongful trading').

A corollary is that the risk of a transaction at an undervalue or engaging the liability of the seller's board and management is heightened.

Mitigation strategies

Depending on the circumstances, the parties may turn to a number of mitigation strategies:

- First, the purchaser will be well advised to due diligence the financial condition of the seller. It may be, for example, that while a group is distressed, the particular entity selling the assets is healthier with the result that the risk of bankruptcy and challenge may be remote.
- For the board to protect itself against liability claims (and to defeat a claw-back

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action as well), it is often critical that there be a record of arm's length disposition process conducted in good faith with the assistance of experienced advisors and resulting in reasonable terms.
- The seller's board should seek a fairness opinion from a financial advisor for additional comfort.
- The seller's board should, as usual, create contemporaneous records of the various steps undertaken in the disposition process.
- The purchaser-creditor should avoid structuring the transaction in the form of a credit bid.

Alternatively, where the risks to the parties remain substantial, they may turn to in-court transactions.

In-court transactions

Switzerland has its own version of 'Chapter 11-type' restructurings. These proceedings can serve to transfer assets or a business to a purchaser and proceed with the orderly liquidation of the seller under a plan of reorganisation approved by the creditors and the court.

In addition, a solid framework has emerged for 'Section 363' type court-approved asset sales.

These court-approved sales have been the subject of recent case law and are discussed below.

Nuts and bolts of a Swiss restructuring

Companies can restructure pursuant to a plan of reorganisation with the usual checks and balances: the creditors will vote on the plan and the bankruptcy court must confirm it. These proceedings, commonly referred to as 'composition proceedings', exist alongside the traditional bankruptcy route aiming to liquidate the company.

Composition proceedings are initiated at the request of the company or a creditor eligible to file for bankruptcy. If the bankruptcy court approves the request, it will grant an interim stay or moratorium protecting the company from enforcement actions by its creditors.

If, during the interim moratorium, the bankruptcy court concludes that there are prospects for a restructuring or court-approval of a composition, it will then approve a definitive moratorium.

Importantly, during the interim and definitive moratorium, the company and its board and management typically keep control of the business and the assets, usually under the supervision of a court-appointed 'trustee'.

However, the company cannot dispose of its fixed assets or the entire business without the approval of the bankruptcy court or, if set up by the court when approving the definitive moratorium or later, the creditors' committee. This important provision is the underpinning for court-approved asset sales.

Key steps of a court-approved asset sale in Switzerland

Court-approved asset sales, while often labelled 'pre-packaged deals', in fact have features of a US style Section 363 sale.

A typical template for such an asset sale is as follows:
- The seller markets the assets pursuant to a reasonable process designed by the board with the help of its advisers.
- The seller negotiates an asset sale agreement with the selected bidder and simultaneously prepare its filing for composition proceedings.
- The asset sale agreement is conditional upon, among other things, the court granting an interim moratorium and approving the asset sale.
- The seller files for composition.
- Unless there is obviously no prospect for a restructuring or court approval, the bankruptcy court approves the interim moratorium. It also adopts measures intended to protect the assets of the company (essentially, the appointment of the trustee).

Determination by the court

The court, when requested to approve the asset sale, will establish whether:

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- There is urgency in completing the asset sale (e.g. to settle suppliers or wages and to maintain goodwill);
- There has been a robust market check designed and implemented with the assistance of specialist advisors to elicit the highest bid (i.e. ensuring that all interested parties have been allowed to bid). A public auction however is not required. The court will be particularly sensitive to any indication that the bidder is closely related to the seller or that the parties may have colluded; and
- The liquidation proceeds in a bankruptcy would likely be lower (e.g. in consequence of a loss of goodwill) with the result that the asset sale is in the best interests of the creditors.

If the bankruptcy court is satisfied that all conditions are met and the transaction is in the best interests of the creditors, the court may approve the sale.

The sale can then be effected as a straight asset sale or a hive-down.

Upsides of an in-court transaction

Court-approved asset sales have many upsides:

- The decision to approve the interim moratorium is not appealable (although it cannot be excluded that the decision be null and void – a very high bar, such as where the bankruptcy court does not have jurisdiction over the matter).
- Creditors do not have a right to be heard or to participate in the approval process of the bankruptcy court. In addition, creditors do not have standing to appeal from the decision of the bankruptcy court approving an asset sale, although it cannot be excluded that the court’s decision be null and void (a high bar).
- The court-approved asset sale cannot be challenged by way of a claw-back action even if the composition proceedings were to fail and the seller were to be liquidated in traditional bankruptcy proceedings.
- Special rules apply to the transfer of employment contracts: they only transfer to the purchaser if that has been agreed by the purchaser. A transfer of assets however will still require the seller to inform the works’ council or, if there is not any works’ council, the employees themselves ahead of any transfer of a business. If measures affecting the employees are envisaged, the works’ council or the employees must be consulted before the measures are implemented.
- While the overall timeframe will depend on a number of variables, including the size and complexity of the assets, since the creditors do not need to be consulted, a court-approved asset sale can be completed relatively rapidly. In a recent case, the bankruptcy court approved the interim moratorium within two days. The asset sale was approved six days later by the court.
- Unlike Section 363 sales in the US, the sale process can be kept relatively confidential in an effort to manage the business’s clients and suppliers. Both the interim moratorium and the asset sale approval will not be made public if applicable conditions are met.

A firm foundation

Bankruptcy courts have approved asset sales within short timeframes with an eye on preserving the goodwill of businesses and maximising recovery for creditors. Important procedural issues have recently been litigated up to the Swiss Supreme Court, giving a firm foundation to the authority of the bankruptcy courts to approve asset sales during the interim moratorium when time is of the essence in a ‘melting ice cube’ scenario. These developments have greatly expanded the ability of companies to restructure quickly in order to salvage viable businesses alongside out-of-court transactions and Chapter 11-type composition proceedings.