Company law revision / the Federal Council's proposal Threat of insolvency, loss of capital and over-indebtedness

At the end of 2005, the Federal Council fired the starting shot for a revision of company law by presenting a preliminary draft and an accompanying report. Back at the end of 2007, the Federal Council submitted a dispatch and a comprehensive draft, which also contained provisions of accounting legislation. Before the Federal Parliament, however, was even able to start deliberating company law, the popular initiative «against fat-cat salaries» was launched in February 2008. The effect of that was that the company law revision was placed on the back burner. The revision of accounting legislation was separated from the revision of company law. In the meantime, the new accounting legislation has come into force.

After the Swiss people had accepted the initiative «against fat-cat salaries», it was implemented with the Ordinance Against Excessive Remuneration in Listed Companies dated 20 November 2013 (the «Ordinance»). On 28 November 2014, the Federal Council reopened the discussion on reforming company law by submitting a new preliminary draft for consultation. This led to numerous, detailed opinions, and, having worked its way through them, the Federal Council adopted a dispatch on company law revision on 23 November 2016. It is to be expected that in the course of the forthcoming deliberations, the proposal will still undergo several amendments.

We have produced six articles in our «In a nutshell» series, in which we present the proposed changes. This particular «In a nutshell» deals with the threat of insolvency, loss of capital and over-indebtedness.

You can consult the other «In a nutshell» articles by choosing the appropriate links:

- Rules on establishing companies and capital **LINK**;
- General meeting and board of directors **LINK**;
- Unregistered registered shares and shareholders' rights **LINK**;
- Return on benefits **LINK**;
- Implementation of Art. 95 para. 3 of the Federal Constitution and gender representation guidelines for listed companies **LINK**.

I. Aims

Through various provisions, the Federal Council's proposal is setting out to create incentives for companies to adopt the necessary restructuring measures at an early point in time. It is aiming to ensure that the board of directors has an enhanced awareness of liquidity and capital adequacy by both broadening its room for manoeuvre and specifying its duties in more detail. The idea of protecting equity capital with reference to the balance sheet is maintained. There are still duties to take action in the event of a loss of capital and over-indebtedness. There is, however, also a new aspect in the focus on liquidity.

In addition to all this, company law is to be better coordinated with the composition proceedings that has been applicable since 1 January 2014 in accordance with the Debt Enforcement and Bankruptcy Act.

II. Threat of insolvency

The justified concern of a threat of insolvency is taken to be a **new «alarm bell»**. If there is a justified worry that the company will become insolvent within the next six months, then the board of directors must draw up a liquidity plan and proceed to an assessment of the company's economic situation. In the case of companies that are required by law to undergo an ordinary audit, the crucial period of time is twelve months.

An **insolvency** exists if the company is no longer able to meet up to those liabilities that are due and thus neither has the necessary funds to meet the liabilities that are due nor the necessary credit to be able to obtain such funds as an emergency measure. Justified concern of insolvency exists especially if there are more and more indications that the company is not going to be able to meet its payment obligations in the coming six or twelve months, either as a consequence of individual occurrences or on account of structural changes in the corporate environment. The impossibility of making one payment punctually does not constitute insolvency (Federal Court decision BGE 109 III 77).

The **liquidity plan**, which is to be drawn up by the board of directors, is a forward-looking statement of future cashflows over a time span of six or twelve months. The liquidity plan may take the expected effects of the planned restructuring measures into consideration. The Federal Council's proposal has abandoned the obligation to perform an audit of the liquidity plan that had been included in the preliminary proposal.

If it emerges from the liquidity plan that there is a threat of insolvency despite the planned restructuring measures, then the board of directors must take further **measures**. These may be in the form of a cut in capital, a capital increase or the opening of composition proceedings according to Art. 293 of the Debt Enforcement and Bankruptcy Act. The Federal Council's 2016 proposal has withdrawn from the mandatory requirement to convene a general meeting, as had been envisaged in the preliminary proposal. The board of directors must act «with the appropriate haste». The proposal – rightly – does not prescribe a deadline, since the duration of the restructuring measures must be judged in the light of the specific circumstances in each individual case depending on differing factors, such as membership of a group of companies, the size of the business, its sector and the complexity of the measures needing to be taken.

It would be wrong to underestimate the **demands on the board of directors**. In its basic structure, a liquidity plan is actually a prospective cashflow statement (cf. on this specific point Peter Böckli, SZW 2015, p. 498). It needs to be based on a business plan, which ought also to include consideration of the planned restructuring measures. Given a planning horizon of twelve months and assuming a normal trend in business, such a plan is, however, unlikely to be anything more than pure speculation. Twelve months is also too long for companies obliged to perform an ordinary audit. In a crisis situation, other uncertainties occur on top of this. Banks strike out credit limits, suppliers demand advance payment, and the best employees take a serious look around the jobs market. Assessing the company's economic situation will be guided by the catalogue of elements to be included in the management report as laid down in Art. 961c para. 2 of the Code of Obligations (risk assessment, orders and assignments, research and development activities, extraordinary events and future prospects). The board of directors will be well advised for liability reasons to ensure that there is a written record of the liquidity plan and its appraisal. It is likely to happen that the boards of directors of smaller companies will often be unable to cope in such a situation, especially if they are not familiar with cashflow statements, risk assessments and management reports. Accounting legislation has exempted companies without a duty to perform an ordinary audit from these additional requirements in connection with the management report. An additional consideration is that smaller companies have often decided to do without auditors, and so there is no specialist contact they can call on in the crisis situation.

III. Loss of capital

According to the Federal Council's proposal, the key warning indicator used to date of a loss of half the capital is to be replaced by the loss of **one third** of the nominal share capital and the legal reserves. Raising the trigger threshold is intended to sharpen the alertness of the board of directors at the onset of a crisis and ensure that they take a careful look earlier on at capital resources and their depletion.

If there is a loss of capital, the board of directors must carry out an **appraisal of the company's economic situation** and take measures to rectify the capital loss.

If the company has no auditors, then the most recent annual financial statement must undergo **at least a limited statutory examination** by a licensed auditor before being accepted by the general meeting. The purpose of that is to make sure that the economic situation is not worse than that presented by the board of directors.

IV. Over-indebtedness

The adaptations proposed by the Federal Council to the provisions applicable in the event of a justified concern of over-indebtedness more or less follow on from the provisions to date. They state that the board of directors must immediately produce an **interim balance sheet** by going concern values and an interim balance sheet by liquidation values. These interim balance sheets must be audited by the own auditors or, if the company does not have its own auditors, by a licensed auditor. If both interim balance sheets show the company to be over-indebted, the board of directors must notify that to the bankruptcy court. Notification of the bankruptcy court can be dispensed with, as under the currently applicable law, if company creditors subordinate their claims to those of all other company creditors to the extent of the deficit (subordination). Subordinations of claims are often an important step in restructuring a company. In this context, the Federal Council proposes that subordinated claims should not be considered as part of the damages with regard to liability actions.

Another possibility that exists is to **delay the timing** of seizing the bankruptcy court if there is a justified and substantial prospect that restructuring will succeed and that the over-indebtedness will not deteriorate considerably during this period of waiting. That corresponds to the Federal Court's practice to date.

The Federal Council's proposal places a time limit of 90 days on this postponement following submission of the interim balance sheet. It does, however, appear doubtful whether there is a need to prescribe a **statutory period of tolerance** and also whether that would bring about the desired legal certainty. The duration of restructuring measures may vary depending on different factors. In a judgment handed down on 7 March 2013, the Zurich commercial court rightly reasoned that in larger and more complex circumstances, such as in a group of companies, restructuring a business does require some time and that it would be denying reality to allow a board of directors a period of only six weeks. On the contrary, it must be possible to rely on the skills of an entrepreneur acting reasonably. The period allowed for the restructuring must last for as long as there are serious efforts with good prospects of achieving it. The Zurich commercial court assumed that the period of eight months from the first recognition of over-indebtedness through to notification of the court did not constitute dereliction of duty (judgment of the Zurich commercial court of 7 March 2013, E. 3.3.29). The other side to that is that 90 days are far too long for small companies to obtain an overview of circumstances if their board of directors is inactive. One final point is that it is not clear at what point in time over-indebtedness will have been «rectified». Is it sufficient, for example, to have a statement of intent from a potential investor or must a share purchase agreement have been signed or even executed? Where there are uncertainties, there will be no way of avoiding filing for tacit provisional composition proceedings with the bankruptcy court.

V. Stay of insolvency proceedings

Article 725a para. 1 of the Code of Obligations in its currently valid form permits the bankruptcy court to delay the bankruptcy upon an application by the board of directors or a creditor. The Federal Council's proposal integrates the advantages of a deferral of bankruptcy into the compositions proceedings and therefore envisages **adaptations in individual points of the composition proceedings in the Debt Enforcement and Bankruptcy Act**. The currently valid rule in Art. 293a para. 2 of that act states that the duration of the provisional stay must not exceed four months. Art. 293c para. 2 of the same act permits waiving the public announcement in justified cases until the end of the provisional stay.

The Federal Council is now proposing that it should be possible in justified cases for provisional composition moratorium to be **extended by a maximum of four more months** upon application by the official receiver or debtor. Thus, as a new provision, it is to become permissible for a provisional composition moratorium to last up to eight months. This is intended to allow the company a period of several months to try to find a restructuring solution under company law or composition law avoiding the potentially negative effects of publication but still maintaining the protection of its creditors.

VI. Conclusion

In the case of companies obliged to carry out an ordinary audit too, it would be better for the liquidity plan to be limited to six months. Even if the Federal Council's proposal has renounced the obligation to draw up a liquidity plan and the mandatory requirement to convene a general meeting set out in the preliminary proposal, the new provisions are still likely to represent excessive demands on smaller and medium-sized companies in terms of both procedure and costs. When it comes to over-indebtedness, the statutory period of tolerance of 90 days does not appear to be appropriate.

December 2016

Dr. Daniel Lengauer, LL.M.
daniel.lengauer@kellerhals-carrard.ch

Basel
Hirschgaesslein 11
P.O. Box 257
CH-4010 Basel
Tel. +41 58 200 30 00
Fax +41 58 200 30 11

Berne
Effingerstrasse 1
P.O. Box
CH-3001 Berne
Tel. +41 58 200 35 00
Fax +41 58 200 35 11

Lausanne
Place Saint-François 1
P.O. Box 7191
CH-1002 Lausanne
Tel. +41 58 200 33 00
Fax +41 58 200 33 11

Sion
Rue du Scex 4
P.O. Box 317
CH-1951 Sion
Tel. + 41 58 200 34 00
Fax + 41 58 200 34 11

Zurich
Raemistrasse 5
P.O. Box
CH-8024 Zurich
Tel. +41 58 200 39 00
Fax +41 58 200 39 11

www.kellerhals-carrard.ch – newsletter@kellerhals-carrard.ch