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Crisis Situation: Guidelines for Boards of Directors

In a crisis situation, there is a shift of competencies from a company's management to its board of directors. These guidelines aim to provide boards and other decision makers with an overview of key measures, duties and various legal aspects. The following areas require particular attention in our experience:

- **Duty to take action**: In crisis situations, the board needs to take command, intensify its supervision of management and implement suitable reporting systems.
- **Need for a realistic analysis**: Faced with the threat of a financial downturn, the board should immediately carry out a realistic analysis of the current situation. We recommend communicating with the auditor early on regarding going concern and valuation factors.
- **Liquidity is key**: Planning, monitoring and conserving liquidity are of vital importance. Measures to conserve liquidity and an appropriate monitoring system should be put in place at an early stage (if not already set up).
- **No group perspective under Swiss law**: The board needs to safeguard the interests of its respective legal entity (and its creditors). This means scrutinising existing group relationships and dependencies. Special awareness is warranted regarding up- / cross-stream payments and cash pooling.
- **Quick restructuring measures**: In addition to taking steps to protect liquidity, the board should swiftly implement restructuring measures, which may include: (i) operational and organizational measures, (ii) balance sheet restructuring backed by raising of new capital, (iii) balance sheet restructuring without any new capital or a combination of all three.
- **Payment restrictions**: As a general rule, a company in financial distress should avoid: (i) payment of claims before they fall due, (ii) granting collateral for existing obligations and (iii) settlement of monetary claims by unusual means of payment (e.g. delivery in kind).
- **Notifications duties**: The board needs to observe formal notification duties under credit agreements, D&O insurance etc.

- **Initiate composition and insolvency proceedings**: If, despite the measures taken, an out-of-court restructuring appears no longer possible, the board can generally choose between two insolvency proceedings: composition proceedings or bankruptcy. If the company is over-indebted, the board may be obliged to initiate such proceedings. The choice of the appropriate proceedings depends primarily on whether the future business development is expected to be "U"-shaped (composition proceedings) or "L"-shaped (bankruptcy proceedings).
- **Repeal of moratorium to file for bankruptcy:** The temporary relief of the board's duty to file for bankruptcy in case of over-indebtedness established in April 2020 was repealed as of 20 October 2020. However, COVID-19 Loans up to CHF 500'000 do still not count as debt when assessing whether a company is over-indebted.

Board duty to take action

In crisis situations, there is a **shift of competencies** from a company's management to its board of directors. The **intensity** and **frequency** of **board supervision** should be increased and, consequently, so should the number of meetings and the level of interaction with management. The board needs to assess whether the existing governance structure is right for the extraordinary situation or if it can be improved (e.g. by installing committees).

Decisions and action taken should be properly **documented** (in particular minutes).

Realistic analysis

Faced with the threat of a financial downturn, the board immediately needs to carry out a **realistic analysis** of the current situation. It has to assess whether the company is capable of a financial turnaround and if remaining as a going concern over the next 12 months is realistic (the latter depends in particular on the company's liquidity). The following principles apply:

- **Single entity view** of each group company; no group perspective (see below).
- **Impairment test** on assets, in particular on equity participations and intra-group receivables.
- Existing **group relationships** should be scrutinised: dependencies, cluster risks, avoid up- and cross-stream payments.
- **Exchange information with the auditor** (impairments, going concern) at an early stage.

Liquidity is key

Planning, monitoring and **conserving liquidity** are of key importance. The following measures to conserve liquidity should be considered:

- Increase **credit limits** with banks.
- Postpone planned **investments**.
- **Short-time work** (*Kurzarbeit*).
- **Further personnel measures** (incl. salary negotiations and redundancies).
- Termination of **non-essential business contracts** (e.g. advertising).

- Improve the company's **accounts receivables management**.
- Potential **prioritization of payments**. In particular **social security contributions** should be paid in a timely manner.
- **Stay** of e.g. rent, taxes, etc.
- **Sale and lease back**.
- **Reduction of inventory**.

If not already in place, a **monitoring system** should be implemented which allows real time visibility of the liquidity situation (actual and generally over the next 12 months) for each group entity and also on a consolidated basis. Based on this, the **liquidity plan** can be revised on a rolling basis as needed.

No group perspective under Swiss law

Swiss (bankruptcy) law takes a single legal entity view and does **not allow** a **group perspective** in a crisis situation. The board of directors of each group entity must therefore safeguard the interests of such entity (and its creditors) and the duties described in this briefing apply to the boards of each group company individually.

Accordingly, when assessing the balance sheet situation, the board must determine whether **impairments** on equity participations or intra-group receivables are necessary. Existing **group relationships** and **dependencies** should be scrutinised closely. Special awareness is warranted regarding up- and cross-stream payments / benefits and cash pooling.

Possible restructuring measures

In addition to taking action aimed directly at conserving liquidity, the board needs to implement further adequate restructuring steps. These may comprise operational and organisational measures, balance sheet restructuring with or without capital inflow or, as usual in practice, a combination thereof:

Operational and organisational measures

- Cost reduction programmes.
- Optimization of processes / structures.
- Product changes.
- Amendments to organisation / management.
- Consultation with experts (turnaround, communication, lawyer, etc.).
- Redundancies – compliance with potentially applicable mass dismissal regulations.
- Request payment extensions for e.g. rent and taxes.
- Sale / closure of unprofitable business units – caveat: fraudulent conveyance.
- Distress sale of assets, hive-off vehicle – caveat: fraudulent conveyance.
- Restructuring merger – in particular assessment of withholding tax implications.

Balance sheet restructuring with capital inflow

- Bank loans.
- Bridge loan from shareholders / affiliates – possible subordination in case of bankruptcy (if loan is deemed to replace equity).
- Regular cash capital increase (CO 650) – 1% stamp duty on contribution, subject to one-time exemption of CHF 10 million in case the amount can be set off against balance sheet losses. Generally, no corporate income tax implications (tax losses carried forward remain unchanged).
- Capital reduction to zero and simultaneous capital increase (*Harmonika*) (CO 732a) – 1% stamp duty on contribution, subject to the above exemption. Generally, no corporate income tax implications (tax losses carried forward remain unchanged).

- Contributions into equity for no consideration – 1% stamp duty on contribution, subject to the above exemption. Generally, no corporate income tax implications (tax losses carried forward remain unchanged; taxable profit can be set off against tax losses carried forward, even if they date back more than seven years).

Balance sheet restructuring without capital inflow

- Release of silent reserves (*stille Reserven*) – corporate income tax on profit resulting from the revaluation.
- Write-up of real estate or equity participations (CO 670) – corporate income tax on profit resulting from the revaluation.
- Refinancing (extend term of liabilities).
- Subordination of claims (CO 725 II).
- Set off available reserves (CO 671 III) – caveat: reduction of reserves from capital contributions.
- Declarative capital reduction (CO 735).
- Debt / equity swap – caveat: discussion whether claim being set off must be valuable; 1% stamp duty on contribution, subject to the above exemption. Generally, no corporate income tax implications (tax losses carried forward usually remain unchanged).
- Debt / asset swap – caveat: fraudulent conveyance; corporate income tax in case of capital gain.
- Waiver of claims (possibly in return for debtor warrants; *Besserungsschein*) – 1% stamp duty on contribution in case of waiver by shareholder, subject to the above exemption; may trigger corporate income tax in case of extraordinary profit (which, however, can be set off against tax losses carried forward, even if they are older than seven years).

Restrictions on payments (fraudulent conveyance)

Based on fraudulent conveyance laws (*Paulianische Anfechtung*), creditors must be treated equally if a debtor is in severe financial distress. No payments may be made to individual creditors in preference over higher or equally ranking creditors.

As a **general rule**, companies in financial distress should avoid: (i) payment of claims before they fall due, (ii) granting collateral for existing obligations and (iii) settlement of monetary claims by unusual means of payment (e.g. delivery in kind). In case of threatening **illiquidity / bankruptcy** subject to certain exceptions, (non-privileged) claims should no longer be paid (including due claims). An assessment of each individual case is required.

Notifications and further points

The board needs to observe formal **notification duties** under credit agreements, D&O insurance, etc.

As an exception to the general rule that only the company is liable for its obligations, directors can ultimately be held liable for unpaid **social security contributions** in case of violation of social security provisions – the board should therefore ensure their timely payment.

Albeit that a successful restructuring may be highly likely, it is only prudent to take time early to consider and, where appropriate, prepare a **plan B** (e.g. hive-off vehicle, composition proceedings, or bankruptcy filing).

Composition and insolvency proceedings

If, despite the measures taken, an out-of-court restruc-

turing appears no longer possible, the board can generally choose between **two insolvency proceedings**: composition proceedings or bankruptcy. If the company is over-indebted, the board may be obliged to initiate such proceedings. The choice of the appropriate proceedings depends primarily on whether the future business development is expected to be "U"-shaped (composition proceedings) or "L"-shaped (bankruptcy proceedings).

Please also see the Bär & Karrer Briefing "Overview of Composition and Insolvency Proceedings".

Duty to file for bankruptcy

If the board of directors has founded concerns (*begründete Besorgnis*) that the company is over-indebted (liabilities are no longer covered by assets; *Überschuldung*), it must prepare **interim balance sheets** at both going concern and liquidation values and have them audited by an approved auditor.

If both such balance sheets show an over-indebtedness, the board must then file for bankruptcy with the court (balance sheet deposition; CO 725 II). Until March 2022, state-guaranteed **COVID-19 loans** of up to CHF 500'000 will not be counted as debt for purposes of assessing whether or not a company is over-indebted within the meaning of CO 725 II.

If a continuation of business activities during the next 12 months is likely not possible (no **going concern**; in particular due to lack of liquidity), financial accounting must switch to – usually substantially lower – liquidation values (CO 958a II); and the board must file for bankruptcy if the interim balance sheet applying liquidation values shows an over-indebtedness. Therefore, illiquidity often leads to over-indebtedness, which in turn triggers the duty of the board to file for bankruptcy.

No filing for bankruptcy is required, if creditors subordinate claims at a level sufficient to cover the over-indebtedness or if the company files for composition proceedings. Furthermore, a **short delay** in filing for bankruptcy (max. four-six weeks) is admissible, if the board immediately implements specific restructuring measures and there is a realistic prospect of a long-term financial recovery of the company. If the board does not file for bankruptcy despite obvious over-indebtedness, the auditor is obliged to make the bankruptcy filing instead.

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