Practice Guides

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Distressed M&A in Switzerland

Alexander Blaeser and **Markus Wolf**[1]

Introduction

In distinction from traditional M&A transactions, the term distressed M&A is typically used to refer to transactions regarding the sale and acquisition of shares or businesses involving one or several parties or companies that are in financial distress. This may be a seller but also the target company or target business itself. The level of distress may range from companies being in early discussions with their creditors regarding their liquidity needs while still having some room to manoeuvre, over companies facing the threat of impending termination of their credit lines, or companies being subject to (temporary) liquidity shortages to already insolvent or over-indebted companies. But also other forms of operational distress or emergency situations can result in similar challenges for the affected company or business, even if such circumstances may not have resulted in an immediate financial crisis.

Distressed M&A comprises a wide range of processes and transactions that may involve parties, considerations, requirements and restrictions that are different from traditional transactions and may vary significantly from case

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to case. Accordingly, each transaction and process may look very different depending on the kind and level of distress of the seller or the target. A company that is not (yet) subject to an imminent risk of insolvency may be able to conduct a rather traditional sales or auction process, whereas a company that is close to insolvency will only have limited options to proceed and will have to act quickly. Compared with a traditional transaction, a distressed M&A process will typically be an imperfect process, often characterised by more and different players (in particular lenders or other creditors), a high degree of urgency, a reduced access to information for potential buyers and often a rather imbalanced risk allocation between seller and buyer. That being said, for investors with the necessary experience, financial means and risk appetite, distressed targets can be investment and growth opportunities at attractive valuations.

In this chapter, we will provide an introduction to the Swiss legal framework for companies in financial distress, followed by an overview of certain available options and their key considerations and implications with respect to Swiss companies at different levels of financial distress.[2]

Swiss legal framework for companies in financial distress

Insolvency proceedings triggers

Illiquidity leading to over-indebtedness

Pursuant to Swiss corporate law, the board of directors must monitor the corporation's solvency and initiate measures to reinstate its liquidity in case of an imminent payment incapacity (ie, a permanent inability to meet its due financial obligations). Given that the inability needs to be permanent, this scenario will often coincide with the corporation losing its ability to continue as a going concern. If there is no going concern scenario, the corporation may no longer account for going concern values and must switch its accounts to

2 For simplification, we will exclusively refer to the Swiss corporation (*Aktiengesellschaft*) and its board of directors (*Verwaltungsrat*), while most considerations also apply to the Swiss limited liability company (*Gesellschaft mit beschränkter Haftung*) and its managing officers (*Geschäftsführer*).

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liquidation values. As such values are usually lower than going-concern values, the corporation may be over-indebted, which results in the obligation of the board of directors to file for bankruptcy or apply for a composition moratorium.

Furthermore, bankruptcy proceedings must be initiated if the shareholders' meeting resolves on the dissolution of the corporation as a result of its illiquidity.

Over-indebtedness

If the board of directors has or should have reason to believe that the corporation is over-indebted (ie, its debts exceeding its assets, resulting in negative net equity), it is required to immediately prepare interim financial statements based on going-concern values (provided a going-concern scenario is realistic). If the interim financial statements still show an over-indebtedness or a going-concern scenario is not realistic, the board of directors is required to prepare interim financial statements based on liquidation values.

If the over-indebtedness is confirmed in the balance sheet based on liquidation values, the board of directors is by law required to file for bankruptcy with the competent court or apply for a composition moratorium unless one of the following exceptions applies:

- Creditors subordinate their claims and the interest accruing thereon in an aggregate amount not less than the amount of the corporation's over-indebtedness to the claims of all other creditors.
- An out-of-court restructuring to remedy the over-indebtedness is substantially likely within a reasonable period of time but no later than 90 days after the audited interim financial statements are available and provided that it is substantially likely that the claims of the creditors are not additionally jeopardised by such restructuring.

Formal insolvency proceedings

Bankruptcy proceedings

A corporation may file for bankruptcy upon determination of illiquidity or over-indebtedness. Further, individual creditors can initiate bankruptcy

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proceedings after having gone through the statutory debt enforcement procedure. In addition, creditors may apply to the competent bankruptcy court for an order to declare the debtor's bankruptcy without such procedure if the creditor can demonstrate that the debtor has generally ceased to make payments of debts when due.

Upon the opening of bankruptcy proceedings, all seizable assets and receivables of the debtor become part of the bankruptcy estate. The bankruptcy estate's assets can be administered and disposed of only by the bankruptcy administration or a bankruptcy administrator.[3] Further, all claims against the debtor (except for those secured by a mortgage on immovable property) will become immediately due. All claims whose object is not a sum of money are converted into monetary claims of corresponding value. Creditors can no longer enforce their claims individually, but are all subject to the rules of the Swiss Debt Enforcement and Bankruptcy Act (DEBA). Depending on the size and the complexity of the estate, the bankruptcy administration may decide to proceed with ordinary or summary bankruptcy proceedings, or to discontinue proceedings where there is a lack of funds to conduct even summary proceedings. The opening of bankruptcy proceedings is publicly announced. The proceedings result in a cessation of the debtor's operational business and ultimately lead to the liquidation of the debtor's assets.

The debtor's obligations for delivery of goods and services are requalified into financial obligations unless the bankruptcy office/administrator decides to perform the obligations on the debtor's behalf.

For contracts with continuing obligations, creditors' claims will only be recognised if they have arisen prior to the first possible date for termination of the contract following the opening of bankruptcy, and such claims constitute ordinary bankruptcy claims. If, however, the bankruptcy administrator insists on the creditor's performance under the contract (eg, in the case of a continuation of a lease agreement), the consideration owed to the creditor becomes a privileged claim to be paid in priority over distributions to ordinary creditors.

3 A private bankruptcy administrator is appointed only in ordinary bankruptcy proceedings, whereas the vast majority of cases are summary bankruptcy proceedings that are handled by the public bankruptcy administration/bankruptcy offices.

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Composition proceedings

A debtor or, under certain conditions, a creditor can apply with the competent court for a composition moratorium in order to seek a restructuring. In such proceedings, courts will first grant a provisional composition moratorium for a maximum of four months (extendable by an additional four months). Courts can refuse a provisional composition moratorium only if there are no prospects for a restructuring or for the confirmation of a composition agreement.

As a general rule, the court will order the public announcement of the provisional moratorium (including in public registers such as the commercial register). On application, the court may agree to waive the public announcement until the end of the provisional moratorium ('silent composition moratorium'), provided that the protection of third parties is guaranteed. In most cases, together with granting a provisional moratorium the court will appoint a commissioner in order to conduct the composition proceedings, supervise the debtor and to examine prospects for a restructuring or the confirmation of a composition agreement. In justified cases, the court may waive the appointment of a commissioner, which is, however, by law not possible in the case of a silent composition moratorium.

In contrast to bankruptcy proceedings, composition proceedings do not necessarily result in an immediate cessation of the debtor's business activities, but are meant to allow, among other options, for a restructuring of the debtor, including a sale of assets, and to result in a better outcome for the creditors than bankruptcy proceedings. Recently, a regional court in the canton of Zurich decided that even an envisaged sale of certain parts of the debtor's business with a subsequent application for bankruptcy of the debtor (and its remaining assets) could be a sufficient basis for granting a provisional composition moratorium.[4]

If, during the provisional moratorium, there is prospect for the debtor's restructuring or confirmation of a composition agreement, the court will grant a definitive composition moratorium for a further four to six months (extendable

4 Order of the regional court (*Bezirksgericht*) Bülach EC200010-C/Z1 of 5 May 2020.

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to a maximum period of two years). The definitive composition moratorium will be announced publicly and cannot be waived.

During the composition moratorium (1) no debt collection proceedings and bankruptcy proceedings can be initiated against the debtor and pending proceedings are stayed, (2) any interest on unsecured claims ceases to accrue and (3) the debtor's power to dispose of its assets may be restricted and subject to the approval or the management of the commissioner and in certain cases a creditor committee. If there are no prospects for the debtor's restructuring or for the confirmation of a composition agreement after the moratorium, the court will open bankruptcy proceedings.

If a composition agreement appears achievable, the commissioner will call a meeting of creditors to approve the composition agreement. There are two types of composition agreements: ordinary composition agreements and composition agreements with assignment of assets to third parties. The composition agreement is subject to the approval of the composition court. Upon confirmation of the composition agreement by the composition court, the composition agreement becomes binding on all parties involved. Following the approval of a composition agreement, all debt collection proceedings are ceased. As for pledged assets, the part of the secured claims that is covered by the collateral remains unaffected by the composition agreement. Any realisation proceedings relating to pledged assets can be continued from the time of the judicial confirmation of the composition agreement.

Avoidance actions

Creditors wishing to enter into contracts with a debtor in financial distress should carefully review those contracts in light of the risk of potential avoidance actions. A debtor in financial distress must ensure that its actions do not result in an unlawful prioritisation of individual creditors over other creditors. The bankruptcy administration and, under certain conditions, individual creditors can sue for the avoidance of actions by the debtor that (1) were taken by the debtor during a certain period (of one year or five years) prior to the opening of the debtor's bankruptcy (the *période suspecte*), (2) were to the disadvantage of the debtor's creditors and (3) fulfil the requirements of one of the avoidance provisions set out in the DEBA, which relate to the following:

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- Voidability of gifts and gratuitous dispositions (*période suspecte* of one year).
- Voidability due to over-indebtedness of the debtor (*période suspecte* of one year) – that is, the debtor carrying out the following acts while being over-indebted: (1) granting of collateral that the debtor was not previously obliged to provide; (2) settlement of a monetary debt in another manner than in cash or other usual means of payment; or (3) payment of a debt that is not due.
- Voidability for intent (*période suspecte* of five years) – that is, carrying out acts with the intention of disadvantaging its creditors or favouring certain of its creditors and such an intention was recognisable to the other party.
- Voidability of set-off – that is, the third-party debtor acquired a claim against the primary debtor prior to the opening of such debtor's bankruptcy, but in awareness of its payment incapacity, in order to gain an advantage for itself or a third party by way of set-off and to the detriment of the bankruptcy estate.

As a result of the broad interpretation in Swiss case law of the requirements of the avoidance action for intent, a debtor's board of directors is essentially obliged to the equal treatment of creditors as soon as it is aware of a situation of financial distress.

Avoidance actions that are available in the debtor's bankruptcy are also available after the court's confirmation of a composition agreement with the assignment of assets,[5] in which case actions taken by the debtor during the respective periods prior to the grant of the definitive composition moratorium are relevant.

Distressed M&A prior to the opening of bankruptcy or composition proceedings

Overview

Prior to the opening of bankruptcy or composition proceedings, distressed M&A transactions are in principle governed by the same legal framework

5 As opposed to an ordinary composition agreement, upon the confirmation of which avoidance actions are not available.

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as traditional transactions. While this gives the involved parties more room to manoeuvre and allows for the use of common transaction structures and instruments, such transactions are more sensitive in view of liability claims against corporate bodies and avoidance actions.

While a distressed sales process is typically conducted in parallel to negotiations with the company's lenders or other creditors, the corporate bodies are and remain fully competent and responsible for the initiation and execution of the transaction, including the selection of potential bidders, the disclosure process, the negotiations, the approval as well as the execution of the transaction. This entails that the corporate bodies are subject to the same liability regime with respect to their decisions, acts and omissions in the course of a distressed transaction as they would be if the company or business was financially sound. Due to the distressed situation and the risk of bankruptcy or composition proceedings being opened, the likelihood of liability claims being filed against the corporate bodies in this context is significantly higher than in other transactions. This can also apply to the company's lenders or other creditors who may become liable as de facto corporate bodies if they engage in decision taking for the distressed company.

Similar considerations apply with respect to potential avoidance actions. As avoidance actions may only be filed with respect to actions taken during certain periods prior to the opening of bankruptcy proceedings or the confirmation of a composition agreement with assignment of assets, and given that distressed companies face a higher risk of (inadvertently) treating certain creditors preferentially, there is a higher likelihood that the risk of avoidance actions may in fact materialise with respect to a transaction.

Therefore, in a sales process involving a distressed company that is not in insolvency proceedings, special attention must be given to any acts or omissions which could give rise to potential liability claims and/or avoidance actions in case of a later opening of bankruptcy or composition proceedings. The corporate bodies of the distressed company (but also any buyer) will thus want to make sure that an adequate sales process is conducted, the transactions are entered into at market conditions and sufficient precautionary measures are in place to make sure that no wrongful preferential treatment of certain creditors takes place and to prevent that the distressed company has to file for bankruptcy or request a composition moratorium following completion.

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That being said, a sales process prior to and with the goal to avoid formal insolvency proceedings can in various respects be advantageous for the distressed company and its corporate bodies but also for its creditors. As long as the corporate bodies are fully competent, they are usually able to act quickly, flexibly and confidentially. In particular the confidential treatment of the process will be of essence, because only for as long as the distressed situation is not public and only known to a limited number of external parties, the company may be able to continue to operate its business in the ordinary course, retain key employees as well as material customers and suppliers, and to generally maintain the value of its business. The more information becomes public about the distressed situation, the more difficult the negotiations with creditors and the execution of a sales process will be.

Sales process

The earlier and faster a company is able to act in a distressed situation, the more time and options are usually available for a successful sales process. If there is no imminent risk of insolvency, the distressed company or its shareholders may be able to conduct a rather traditional sales or auction process regarding the distressed company or its business. While this process will have to be pursued in a timely manner, the corporate bodies and/or the shareholders may still be in a position to offer an accelerated but adequate disclosure process and provide interested parties with such information as they will usually require to properly evaluate the target and to make an informed and well-founded offer. Such a process can be beneficial for the parties involved as the acquired business or assets may not (yet) be overly impaired by the financial situation.

In the event that the financial situation of the distressed company or its business has already become critical, the execution of an accelerated yet formal sales process or auction may no longer be feasible. In such a situation, the corporate bodies and/or the shareholders will only be able to offer the target company or its assets/business to a limited number of naturally interested parties (such as competitors), which will leave uncertainty regarding the adequateness and competitiveness of the terms and conditions offered. Likewise, there will usually not be enough time for the corporate bodies of the seller to obtain expert opinions regarding the valuation of the target business

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or assets. The buyer, for its part, will often not be able to receive and review all information that it would typically require in order to properly evaluate the target and to make a well-informed offer. This will then be taken into account by the buyer in its valuation and the offered purchase price, given that the availability of other remedies will be limited.

A distressed debtor's financial creditors will often be willing to support a restructuring and sales process, provided that they have reason to believe that their recovery proceeds will be better than in insolvency proceedings. In order to give the debtor the necessary room and time to preserve the value of the business, arrange for a restructuring and/or sales process, and to refrain from applying for formal insolvency proceedings, financial creditors may be willing to enter into standstill agreements, refraining for the time being from taking further steps to enforce their claims. This kind of support can be essential for the execution of a successful sales process.

Transaction structures

Sale of assets or business

Unlike traditional sales processes, distressed transactions will typically take place as an acquisition of assets and liabilities or business (asset deal). Such a transaction structure has the advantage that the parties are free to agree which part of a business or which assets and liabilities are acquired by the buyer (usually such portion of the distressed company's business that can be continued), while all other assets and liabilities, in particular any unknown or contingent liabilities, remain with the selling entity. Upon completion, the buyer will be liable only for such liabilities that it has agreed to take over or that result from the acquired assets. The same applies to contracts, in particular contracts with unfavourable terms, which are not specifically taken over by the buyer. That being said, the buyer takes over by operation of law the employment relationships of all employees of the acquired business, including all rights and obligations resulting therefrom, unless the respective employees refuse such transfer.

The acquisition of specific assets and liabilities or a business allows the buyer to focus its due diligence efforts primarily on such assets, liabilities and contracts that are within the transaction perimeter. This is particularly important in case of urgency or if only limited information can be obtained during the process.

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However, as part of its due diligence, the buyer will have to make sure that the acquired assets and contracts comprise all such items that are necessary in order to allow the buyer to continue the business after closing or to integrate them successfully in its own business. In contrast to an acquisition of shares, an acquisition of assets and liabilities or a business under Swiss law typically requires a rather detailed description and listing of all assets, liabilities and contracts that are part of the transaction. This requires significant time and resources from the selling entity to prepare such information, but also from the buyer in order to review and compare with the results of its (limited) due diligence. Also the consummation of an asset purchase is normally more complex than a simple acquisition of shares as the transfer formalities for each category of assets must be complied with. In the event that any acquired assets have been pledged or otherwise encumbered by the seller, the respective encumbrance must be removed with consent of the pledgee before the transfer can be effected.

As regards contracts of the target, the transfer by way of asset deal can be particular burdensome. Unlike in a share purchase where primarily in case of change of control clauses the counterparty's consent is required, the transfer of contracts in an asset/business purchase will in most cases require counterparty consent, unless the contract itself permits a transfer or is transferable pursuant to statutory law. As obtaining such consents is time-consuming and can compromise confidentiality, the parties will typically agree to obtain explicit consent only for contracts that are necessary for the buyer's ability to continue the business or that are otherwise of material importance, while with respect to other contracts, the buyer will often have to bear the risk that the counterparty refuses to accept the transfer. With respect to contracts that are of particular importance, counterparty consent will, even in a distressed situation, be a condition precedent to closing.

In the case of a sale of all or substantially all of the assets of the selling entity (de facto liquidation) or a change of its corporate purpose, the transaction has to be approved by the shareholders' meeting of the selling entity. Depending on the shareholding structure, this requirement may result in a significant delay of the transaction, in particular if formal convocation requirements have to be obeyed. This can even lead to significant uncertainty regarding the feasibility of the transaction.

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Sale of shares

A sale and acquisition of shares (share deal) in a Swiss company is usually more straightforward in terms of documentation and faster to execute and implement than an asset purchase. By acquiring the shares, the buyer indirectly takes over all assets, liabilities, contracts and employees of the target company, which also includes in particular all permissions, approvals or licenses issued to or held by it. Consents or approvals by third parties, in particular under any contract or licence, only need to be obtained if such a consent or approval is required by a change of control provision or by applicable law. Also the consummation of such a transaction can be simple and focused on the transfer of the shares against payment of the consideration as well as certain ancillary corporate actions, although there will typically be further documents and agreements to be negotiated and executed. However, similar issues as in case of an asset purchase will arise if the acquired shares have been pledged or otherwise encumbered. In this case, the respective encumbrance will need to be removed with consent of the third-party beneficiary before the transaction can be effected. Depending on the financing structure of the target company and/or the seller group, the release of security over other assets of the target company may also be required in order to allow the buyer to acquire the full benefit of the acquired company.

Despite certain advantages, an acquisition of shares will usually not be viable if the target company/business is in financial distress as a potential buyer would thereby acquire all obligations and liabilities, including any contingent and unknown liabilities, of the target company. Due to the inherent urgency of a distressed sales process, the buyer will typically not be able to get sufficiently comfortable regarding the liabilities of the target as the extent of disclosure and the level of due diligence will often be limited. Nevertheless, there may be situations where an acquisition of shares is also feasible in a distressed environment, for example where the transaction is limited to certain healthy group companies and the buyer is able to get sufficiently comfortable with respect to their financial status, or where the acquired company holds permissions, approvals or licences that are required for the target business but cannot be transferred in an asset/business purchase. A buyer may also get comfortable with a share purchase if large creditors of the target are willing to make concessions as part of the transaction. The respective negotiations, typically with the

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main financial creditors of the target, are normally conducted in parallel with the sales process and will require additional time and resources of the parties.

Contractual protection measures

Irrespective of the transaction structure, a buyer may also in a distressed transaction be able to obtain certain contractual protection and remedies against the seller and/or its affiliates. The available protection measures include substantially the same instruments as in traditional transactions, in particular representations and warranties as regards unknown risks of the target as well as indemnification undertakings by the seller regarding specific known risks. Depending on the particularities of the specific case, also the seller's (direct or indirect) shareholders or other affiliates may be willing to provide a buyer with additional protection. This can be the case if it is in the interest of the relevant entities to avoid the opening of formal insolvency proceedings, to mitigate the risk of liability claims or avoidance actions, or in order to achieve a release of security provided over its own assets or guarantees granted for the benefit of the distressed entity or its financial creditors.

The value of such contractual protection measures for a buyer will primarily depend on the financial situation and solvency of the seller or the respective other party, and the buyer's ability to enforce potential claims. In particular if the seller is (also) in a distressed situation, the value of such contractual protection measures can be very limited. Similar to traditional transactions, a buyer's ability to enforce potential claims against the seller may be enhanced by deferred or retained purchase price elements or an escrow mechanism, enabling buyer to claw back a part of the purchase price. Such elements will, however, not be available in situations where all or substantially all of the consideration will be required by the seller to pay its creditors.

In principle, warranty and indemnity insurance could also provide a buyer with additional protection. In distressed transactions, however, the limited ability to conduct a comprehensive due diligence as well as the urgent nature of the sales process will make it in practice difficult for a buyer to complete the underwriting process and to arrange for adequate coverage without material exclusions in a timely way.

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In cases where the value of the acquired business or assets for a buyer significantly depends on the continuation of certain contracts with third parties (eg, suppliers or customers) or requires amendments to existing contracts in order to be commercially viable, the buyer will usually require waivers of change of control rights by the respective counterparties or the execution of amendment agreements (eg, regarding terms of a lease). Such actions will usually be required as a condition to (and be effective as of) closing.

In order to mitigate the risk of insolvency proceedings being opened over the seller following completion of a distressed transaction, the buyer will usually request that all or part of the purchase price is used to repay the seller's creditors, if and to the extent possible without an unlawful preferential treatment of individual creditors to the disadvantage of all other creditors. Such a repayment will in any case be required if asset security must be released for the purpose of the transaction. But also in such a case, the repayment may only be effected within the limitations of statutory law in order to mitigate the risk of avoidance actions. Where possible, the buyer will request that the repayment is effected by way of direct payment by the buyer (on behalf of seller) to the relevant creditors.

Distressed M&A in composition proceedings

General aspects

If the financial status of the distressed entity requires immediate action and does not allow for a sales process before the initiation of formal proceedings, the board of directors of the distressed entity may comply with its statutory obligations by applying to the competent court for a composition moratorium to be granted in order to seek a restructuring. As a composition moratorium does not necessarily result in an immediate cessation of the debtor's operations, the distressed entity may be able to maintain the value of its business and assets in substance and to arrange for a sales transactions with respect to at least a portion of its business or assets, in particular if the court grants the provisional moratorium as a silent moratorium without publication. Even if a sales process has been initiated and the negotiations are already well progressed, it may be beneficial for the parties to apply for the opening of composition proceedings as part of the transaction.

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The initiation of composition proceedings and the appointment of a commissioner usually means that the distressed entity loses some flexibility to act and that a sales transaction may to a certain extent be delayed until the commissioner has familiarised itself with the affairs of the distressed entity. While the debtor may in principle continue its business activities under the supervision of the commissioner, the competent court may decide that certain actions may only be validly performed upon approval of the commissioner. Further, the debtor is by law no longer entitled to validly dispose of or encumber its non-current assets, to create pledges, enter into sureties or make gratuitous dispositions, unless such actions are authorised by the competent courts or the creditors' committee (if any), which also influences the debtors ability to enter into a sales transaction.

Despite these disadvantages, Swiss law provides that actions that have been taken during a composition moratorium with the approval of the competent court or, respectively, the creditors' committee (if any) are not subject to avoidance actions in the case of a subsequent bankruptcy or the confirmation of a composition agreement with the assignment of assets. The same applies by law to liabilities that were entered into with the consent of the commissioner during the composition moratorium. In addition, as regards the employees of the distressed company/business, Swiss law provides that a business or a part thereof is transferred during a composition moratorium or based on a composition agreement with the assignment of assets, only such employment relationships are transferred (but with all rights and obligations) as agreed with the acquirer, provided that the relevant employees do not object. Thus, in the case of a distressed transaction after the opening of composition proceedings, the acquirer is able to pick and choose the employees it wants to take over as part of the transaction. Further, the buyer will not be jointly and severally liable with the seller for the transferred employees' accrued salary claims against the seller.

Against this background, a sales transaction after granting of a provisional moratorium can be advantageous for the involved parties, in particular if the risk of a potential insolvency of the selling entity after closing and, therefore, the risk of avoidance actions regarding the sales transaction, cannot be adequately mitigated by way of contractual undertakings. That being said, the involvement of the commissioner in the negotiations, as well as the requirement of approval

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by the competent court, may add additional complexity and uncertainty to the transaction process, and may also require additional concessions by the buyer.

Finally, there is no certainty that the composition court will approve the transaction, in which case, however, the buyer would also not be obliged to consummate the transaction.

Pre-packaged deal (pre-pack)

An attractive deal structure for a distressed transaction is the pre-packaged deal (pre-pack). A pre-pack is usually an asset deal (but could also be a share deal) that is initiated and negotiated before the granting of a provision moratorium but will ultimately be approved by the composition court in composition proceedings over the debtor (ie, not in bankruptcy but in composition proceedings). A pre-pack essentially divides the M&A process into four stages: First, the parties will negotiate the terms of the acquisition, pre-discuss those terms with the designated commissioner (unlike bankruptcy offices the commissioners are not public servants but private practitioners) and sign a business transfer agreement, which is conditional upon obtainment of court approval. Second, the debtor will apply for a composition moratorium. Third, the parties, acting with the support of the commissioner, will ask the composition court to approve the transaction, whereas such request for approval can in urgent cases also be contained in the request for the grating of a composition moratorium.[6] Fourth, after having obtained the court's approval, the parties will close the transaction. The advantage of a pre-packaged asset deal is that the parties can avoid a potential challenge of the transaction through avoidance actions. Further, the purchaser can pick and choose which employees to take over (cherry-picking) and it will not be jointly and severally liable with the seller for the transferred employees' accrued salary claims against the seller. Further, the fact that the transaction is already negotiated and pre-discussed with the composition commissioner before the opening of the composition proceedings provides for a certain level of deal certainty. Nevertheless, there is ultimately no certainty as to whether the court will approve the pre-pack.

6 Order of the regional court Bülach EC200010-C/Z1 of 5 May 2020.

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Statutory law does not provide explicit conditions under which a Swiss composition court must approve (or may decline the approval of) a pre-pack. In our experience, the following points are important for the success of a pre-pack: (1) the commissioner should be aligned with the buyer and the seller (that said, the commissioner has no obligation to act according to the buyer's or the seller's instructions, as its main objective is to ensure the successful restructuring of the company); (2) the pre-pack should be executed quickly after the opening of composition proceedings (ideally during the phase of the provisional composition moratorium); and (3) the parties should demonstrate to the court that the proposed deal respects the following principles:

- There is no decrease in the overall value of the debtor's assets due to the pre-pack.
- The advantages of the pre-pack for the buyer and the debtor do not lead to disadvantages for the other creditors. Such risk exists in particular if the purchase price is too low. The court can also, if necessary, call in an expert to confirm the value of the transferred assets.
- The debtor's actions appear to be fair and reasonable overall.
- The creditors are not worse off than in standard immediate liquidation (the purchase price will need to be higher or at least equal to the liquidation value of the debtor's assets). This will need to be clearly communicated and demonstrated to the court. An argument could be, for example, that if the buyer takes over the employees and the existing agreements, this will result in a reduction of privileged creditor claims and therefore be advantageous for the remaining unsecured creditors.

By law, creditors have no right to appeal against the court's decision to approve the transaction.[7]

Distressed M&A in bankruptcy proceedings

While bankruptcy proceedings are meant to ultimately lead to the liquidation of the debtor's assets and a (partial) payment of the debtor' liabilities, which involves a sale of the debtor's assets, the opening of bankruptcy proceedings

7 Decision 5A_827/2019 of the Swiss Federal Supreme Court dated 18 March 2021.

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and the characteristics of the DEBA will usually result in a material delay and will significantly reduce the chances for a successful sale of the debtor's assets or business as a whole. Any sale of the debtor's assets will be organised by the bankruptcy office and usually takes the form of a public auction or (under certain circumstances) a private sale (ie, a sale to a specific purchaser without having gone through an auction process). As a rule, assets and properties belonging to the bankruptcy estate may only be realised after the second creditors' meeting (if applicable), except for items that are subject to rapid depreciation, require costly maintenance or give rise to disproportionately high storage costs, which may be sold by the administrator without delay. The same applies to securities and other items that have a stock exchange or market price. In these cases, however, the creditors' right to make a higher bid must be honoured.

An advantage of a purchase during bankruptcy proceedings is that the transaction cannot be challenged via avoidance actions (unlike the sale and purchase of the debtor's assets prior to the opening of insolvency proceedings). Further, the purchase price may be lower if there are no (or at least a limited number of) other potential purchasers interested in the assets. As a disadvantage, the value or condition of the asset may deteriorate after the opening of bankruptcy proceedings. For example, the stigma of bankruptcy may impair the value of intellectual property, competitors may infringe the debtor's intellectual property without anyone policing such infringement, software may not be maintained, employees maintaining the assets have moved on, etc. Also, the process may take a considerable amount of time, as bankruptcy administrators are public servants who work on their own timeline and the debtor's assets are typically only sold after the bankruptcy administrator has ascertained the bankrupt's estate (ie, its asset and liability situation). Thus, even in case of third parties being interested to acquire all or part of the assets or business of the distressed company, Swiss law makes a successful sales transaction of an entire business out of bankruptcy rather difficult and unlikely.

Outlook

At the core of distressed M&A transactions lies the trade-off between value preservation and risk minimisation. In the case of an acquisition prior to insolvency, the risk of avoidance actions and personal liability must always be kept

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in mind. The opening of insolvency proceedings marks a game changer for any distressed M&A transaction, with the DEBA providing for a totally different set of parameters. In terms of deal structure, pre-packs can be attractive solutions, but require foresight and planning.

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