The Swiss reorganization law [1] does not meet the demands of a modern reorganization law in many respects. A radical reform is overdue [2]. It is today largely approved that reorganization proceedings under judicial protection are initiated too late. As a consequence, business operations collapse. One of the main goals of a future reformation has therefore to be the maintenance of business operations. Below, some basic considerations about these goals and – to begin with – the legal purpose of reorganization law are taken into account.*

1. Legal Purpose

Looking into the reorganization law induces us, first of all, to question whether the policy of law demands a reorganization law and, if so, what its legal purpose should be. The main issue of these considerations is whether a company’s bankruptcy and liquidation – as a painful, but inevitable consequence of the market-based mechanism – or its reorganization is the more reasonable solution in terms of economic and social policy. In order to discuss this issue it is necessary to contemplate it from two different points of view [3]:

On the one hand, bankruptcy is the legal enforcement measure by which unprofitable companies are liquidated, thus freeing the economy from these harmful elements [4]. In doing so, bankruptcy serves the efficient allocation of resources in the economy. The allocation function ensures that the resources of the economy are allocated to companies that make the best use of them [5]. Furthermore, bankruptcy not only assumes the liability, but also has, through threat of sanction, a preventive influence on debtor’s behavior before bankruptcy [6]. This legal enforcement should strengthen the creditors’ expectations that the debtor would meet its obligations. Thus, it offers an incentive for the creditors to give (more) credit [7]. From this point of view, a «debtor-friendly» reorganization law can provide incentives that adversely affect the economy.

On the other hand, a company’s bankruptcy and liquidation normally causes high costs to the economy. The transition from a running company to mere assets typically involves a substantial loss of value [8]. Moreover, employees, suppliers, and customers depend on the company for their subsistence or financial prosperity. They all stand to suffer from the collapse of the company [9]. These additional losses to the economy have to be taken into account in order to attain allocative efficiency. Liquidation does not always result in efficient allocation of resources. In fact, a more efficient allocation of resources can be in some cases achieved by reorganizing the company [10].

Concerning the prevention of frivolous running into debt, it is important to notice that threat of bankruptcy often fails to have its intended preventive effect. The preventive effect is based on the assumption that those who manage the company are also the company’s owners [11]. Indeed, there are many sole proprietorships in the Swiss economy. However, most of the major enterprises with a large damage potential are incorporated companies [12]. In all these companies, ownership and management are separated with the consequence that bankruptcy all too often affects innocent people [13]. Moreover, it must be pointed out that economic progress depends on the willingness to take extended risks [14].

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In our opinion, the reasons backing the need of a reorganization law prevail. Therefore, it is the responsibility of a progressive legal system to offer financially distressed companies an up-to-date reorganization procedure as a real alternative to bankruptcy. In doing so, the legal purpose should not be to avoid bankruptcy at any price, but to achieve a «symbiosis» between reorganization and bankruptcy [15]. Each individual case should be analyzed as to whether reorganizing the company makes sense from an economic point of view. At the same time, the reorganization procedure has to be implemented in such a manner that the going concern is kept [16].

2. Going Concern

2.1 Current Law

Under the current Swiss reorganization law, the board of directors of a company is de facto not able to file for bankruptcy until the company’s liabilities exceed its assets [17]. But by that time, a company is normally no longer financially able to continue its business [18]. Maintaining the ability to remain in business requires earlier initiation of reorganization proceedings [19]. Reorganization proceedings should be initiated at a time when there are still enough equity capital and liquid assets to maintain the business operations.

2.2 Early Warning System

For this purpose, the current trigger mechanism that the company’s liabilities have to exceed its assets, should be complemented by an early warning system based on equity ratio and liquidity ratios. Liquidity squeezes are critical for the going concern: When the ability to pay in the foreseeable future is not guaranteed, the going concern is compromised as well [20]. Furthermore, in every commercial activity an adequate amount of equity capital is needed to be able to provide the company with the necessary working funds and to cover loss [21]. Therefore, liquidity ratios and an equity ratio are suitable indicators for a financial crisis in any company [22]. Moreover, for every commercial activity there are empirical ratios concerning both indicators, which can be consulted [23].

In view of companies’ diverse economic circumstances and their fluctuating need for liquidity and equity capital depending on the sector and the stage of development, concrete legislative regulation is not appropriate [24]. Instead, for flexibility, companies decide themselves on the adequate ratios suitable for their business. To maintain transparency, they should write them in the articles of corporation. In doing so, it is up to the shareholders to decide whether to establish such a system [25]. This option is justified by the fact that an early warning system can have momentous consequences on the future of the company, and thus on the shareholders’ interests. The system allows the board of directors to file for reorganization proceedings with direct consequences on the shareholders’ interests before the company’s liabilities exceed its assets. Considering this fact, even the creditors’ interests do not justify the legal duty to establish an early warning system. Furthermore, it should be taken into account that the institution of such a system is in the interest of the shareholders as well. The owners acquire an additional instrument for monitoring the management’s performance. This allows them to exercise their membership rights earlier than today in an emergency.

2.3 Initiation of Reorganization Proceedings

As mentioned above, an early warning system can form a trigger mechanism to file for reorganization proceedings in good time. However, there is no incentive for the board of directors to file for reorganization proceedings [27]. Therefore, the board of directors should be legally obligated to take care of the going concern. It must take action at the very moment when the requirements for the continuation of business, i.e. equity capital and liquidity, will not be met in the foreseeable future [28].

As a consequence, the board of directors has to be able to file for reorganization proceedings under judicial protection at the time when the going concern is no longer guaranteed in the foreseeable future [29]. The court must have the power to grant the petition for reorganization proceedings as soon as the board of directors substantiates by prima facie evidence that the going concern is compromised in the short to middle term. The opening of reorganization proceedings does not require the company’s liabilities exceed its assets. Moreover, the company does not have to be insolvent.

According to the current law, the injunction that stops foreclosure, garnish-
ments, and collection activity against the debtor does not automatically go into effect when the petition is filed [30]. The injunction, also called stay, has to be granted by the court. This procedure can take several days. During this period of time the debtor is generally not able to keep his business alive, at least in lines of business which need many liquid funds. The reason for this is that the filing for reorganization proceedings publicizes the financial distress of the company. This publicity typically causes additional cash flow problems [31]. In order to remove this risk for the going concern, the stay of creditor actions against the debtor should automatically be effective at the moment the petition is filed [32].

3. Corporate Governance in Reorganization Proceedings

Good corporate governance is a deciding factor for successful reorganization proceedings [33]. What legislation can and should provide to ensure good corporate governance in reorganization proceedings, is the subject of this section.

3.1 Decision-Makers

In a corporation, fundamental decisions are made by the shareholders [34]. Transferring the decision-making power from the shareholders to the creditors is not justified as long as the corporation is solvent and has no excess of liabilities over assets. Therefore, if the reorganization proceedings are instituted while the company still has liquid funds and equity capital disposable, the shareholders have to participate in the corporation’s decision-making process during reorganization proceedings. Shareholders and creditors have to make fundamental decisions such as voting on the reorganization plan [35].

As a consequence, there are two categories of decision-makers within a modern reorganization procedure [36]. The shareholders could be involved in the decision-making process by judicial arrangement: The court allocates shareholders and creditors to groups with similar interests [37]. Within these groups, they vote on the plan and other relevant matters.

3.2 Corporate Management

3.2.1 Management’s Duties

In reorganization proceedings, much more than in any other situation, the qualified and coherent conduct of business is a question of survival [38]. The management has the required knowledge and experience as well as the specific knowledge of the company, its collaborators, its sector of activities, and its stage of development. Therefore, the present management should remain in charge of the conduct of business during reorganization proceedings [39]. However, in some cases total or partial replacement of the management body is needed in order to avoid keeping detrimental conduct of business. In other cases the engagement of persons with experience in reorganization or other experts can be recommended [40]. In these cases, it is a moot point how and especially by whom these persons should be appointed or dismissed [41].

On this matter, we have to distinguish between appointment or dismissal of members of the board of directors and members to the executive management.

Concerning the board of directors, every creditor and shareholder as well as the trustee [42] should have the right to request the appointment or the dismissal of members of this body. Since appropriate management is of such importance for the success of reorganization, the trustee and all parties in interest should be able to raise a motion at any time prior to the confirmation of the reorganization plan. The power to appoint or dismiss should be given to the court. The competence of the court can guarantee efficient proceedings as well as the neutrality of the decision, which helps its acceptance. For practical reasons, the trustee nominates some eligible persons for election. Moreover, the right of nomination should be accorded every creditor and shareholder.

Concerning the executive management the board of directors should have the statutory power to elect and dismiss these members during reorganization proceedings [43]. In doing so, the exclusive power makes the board’s sphere of responsibility coincide with its sphere of influence [44].

3.2.2 Role of Trustee

The rapidity and quality of decision-making is essential in the reorganization of a company. Efficient continuation of business requires a clear separation of the powers assigned to the management and the trustee. The court should assign neither strategic nor executive functions to the trustee [45]. The exclusive power to conduct business has to be assigned to the management. This exclusive power avoids negative redundancy in the decision-making process and ensures conduct in the general interest [46]. Furthermore, it draws a clear dividing line between the sphere of responsibility of the management and the trustee [47].

The trustee is responsible for supervising the management in general and monitoring the compliance of the management with the plan of reorganization and with the law [48]. Due to this crucial function the trustee should be independent and therefore, not be involved in management. In a situation in which many creditors are disappointed in their expectations, the aspect of independence should not be neglected [49]. However, the independence is not endangered when the trustee cooperates with the board of directors in the preparation of the reorganization plan. On the contrary, it is a good opportunity to
present the concerns of the creditors early in the process and to prevent unnecessary loss of time.

3.3 Excursus: Competence of the Court

The reorganization procedure runs under judicial protection. In order to implement a balance of interests between creditors and shareholders, the powers of the court should be extended. Particularly, it must have the power to confirm a reorganization plan if the plan is likely to be accomplished during the scheduled time [56]. In addition, the complete settlement of the privileged claims as well as the obligations contract during the stay must also seem likely. Thus, essential working funds would be available for reorganization.

5. Conclusion

Modern reorganization law has to meet different interests, and at the same time be practicable and efficient. In view of these requirements, the postulated reform of the Swiss reorganization law is a great challenge which nevertheless requires our every endeavor. Successful reorganization proceedings are not only in the interest of companies, shareholders and employees, but also in the interest of creditors and the public. Thus, the reform would contribute to greater acceptance of the economic system.

4. Financing of Going Concern

For successful reorganization, it is essential that legislation makes it easier for companies to procure the working funds required for the going concern [52]. However, current Swiss legislation does not comply with this demand. According to the Swiss Debt Enforcement and Bankruptcy Act, the court is entitled to confirm the reorganization plan only if the statutory requirements are fulfilled. One of these requirements is as follows [53]: The performance of the reorganization plan, the complete settlement of the privileged claims, as well as the obligations contract during the stay with the approval of the trustee must be sufficiently secured. In most cases, they are secured by cash deposit or by means of a bank guarantee [54]. As a result of these security rights, urgently needed working funds are pledged and no longer available for reorganization of the company. That can strongly compromise the success of reorganization. However, the interest in successful reorganization should prevail over the indemnity of the creditors. For this reason, the provision of security should be abolished [55]. The court should be able to confirm a reorganization plan if the plan is likely to be accomplished during the scheduled time [56]. In addition, the complete settlement of the privileged claims as well as the obligations contract during the stay must also seem likely. Thus, essential working funds would be available for reorganization.

Notes

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1 Swiss legislation provides two instruments for reorganization of financially distressed companies: The composition proceedings to avoid liquidation of an estate (Nachlassverfahren, procedure concordataire) according to article 293 seqq. Debt Enforcement and Bankruptcy Act, hereinafter DEBA, and the grant of a stay of bankruptcy proceedings (Konkursaufschub, apremoiement de la faillite) according to article 725a CO. The CO encompasses the Swiss corporation law. In this article, the term «Swiss reorganization law» comprises these two instruments.

2 This issue is controversial; cf: as a demonstrative example for this dispute Meier/Peyer/Rutenschmann, p. 15 and Daniel Hunkele, Verwalters des Gesetzgebers as well as Daniel Hunkele, Nachlassvertragtrecht. See also Isaak Meier, Helvetischer Weg, p. 691.

3 Concerning these two points of view see Axel Flessner, p. 172.


5 Concerning allocative efficiency see Samuelson/Nordhaus, p. 158; Hans Caspar von der Crone, Markt und Intervention, p. 60.

6 See Reinhard H. Schmidt, p. 32 seq.

7 See Milgrom/Roberts, p. 183 seq.

8 See Bernhard König, p. 4; Siegwart/Caytas/Mahari, p. 132; Forstmoser/Meier-Hayoz/Nobel, § 50 note 207; Andreas Baumgartner, p. 38; Reinhart H. Schmidt, p. 37.

9 See Siegwart/Caytas/Mahari, p. 130. A «snowball effect» is often observed when major companies collapse. They are «too big to fail». Concerning the lack of employees’ diversification see von der Crone/Beyerler/Dédeyan, p. 450 seqq. and Karsten Schmidt, p. 4. An efficient protection of the employees requires an accounting improvement of the protection provisions; see von der Crone/Beyerler/Dédeyan, p. 470 seqq.

10 If inappropriate management is the main cause of the company’s crisis, it does not seem reasonable and efficient to immediately liquidate the company. First, the management should be replaced. Cf. Axel Flessner, who stated that the difference between reorganization and liquidation is only a question of extent (Axel Flessner, p. 190).

11 See Axel Flessner, p. 177 seq.

12 Concerning the importance of corporations in Switzerland cf. Walter A. Stoffel, note 1 seq.

13 The members of the management have to be elected; cf. article 696 para. 2 subsec. 2 CO and Meier-Hayoz/Forstmoser, § 2 note 112 seqq.

14 See Siegwart/Caytas/Mahari, p. 136 seqq.

15 Cf. Isaak Meier, Weiterführung des Unternehmens, p. 5, concerning the fundamentals for successful reorganization; furthermore, see Siegwart/Caytas/Mahari, p. 183.

16 This trigger mechanism for bankruptcy is regulated by article 725 para. 2 CO. According to the current law a debtor can only file for composition proceedings at any time (see article 293 para. 1 DEBA in conjunction with article 295 para. 1 DEBA). But, the court is not able to grant this petition before the company’s liabilities exceed its assets. The granting of a petition would deprive the shareholders of their power too early since they do not have any rights in reorganization proceedings. The shareholders’ deprivation is not justified as long as the company is able to pay its liabilities without exceeding its assets.

17 Cf. Expertenbericht, p. 13. The current law allows the board of directors to wait until it is too late for reorganization (cf. Vincent Jeanneret, p. 1; Siegwart/Caytas/Mahari, p. 147). Therefore, almost all composition proceedings under DEBA end in liquidation, or the composition plan is used to liquidate the business instead of reorganizing (see Lukas Glanzmann, p. 56; cf. Expertenbericht, p. 17). The liquidation of a business results in a dramatic decrease in the assets’ value because in most practical cases it is inevitable that the assets are divided up into pieces. Concerning the dramatic decrease in the assets’ value cf. Forstmoser/Meier-Hayoz/Nobel, § 50 note 207; Reinhart H. Schmidt, p. 37.

18 Earlier initiation of reorganization proceedings is demanded, for example, by Henry Peter, p. 3; Vincent Jeanneret, p. 1; Bernhard König, p. 416.

19 Concerning the allocation of working funds see Milgrom/Roberts, p. 183 seqq. and Karsten Schmidt, p. 8 seq.; Ross/Westerfield/Jordan, p. 494.

20 Concerning the lack of employees’ diversification see Milgrom/Roberts, p. 183 seqq.; Axel Flessner, p. 172, p. 176 seq.; Karl Spühler, p. 27.
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p. 2; Lutz Häussermann, p. 206; Markus L. Schmid, p. 72.

20 Cf. Expertenbericht, p. 15 seq. As a suitable liquidity ratio the cash flow is to be taken into consideration; see also Henry Peter, p. 3, as well as Clarence Peter, p. 4. Cash flow analysis is a crucial tool for measuring insolvency. A company with a sustained negative operational cash flow cannot create enough liquidity from the ongoing business operations. The company is unable to pay due debts without additional external finance. See Schwartz/Stein/Spaniel, p. 49; Ross/Westerfield/Jordan, p. 23, p. 485; Aswath Damodaran, p. 101 seq.


22 See Aswath Damodaran, p. 107.

23 Concerning the equity ratio see Peter Böckli, p. 725; generally seeBrealey/Myers, p. 22 seq.

24 This fundamental conclusion is confirmed by the animadversion on the Austrian reorganization law and the equity ratio therein regulated (see footnote 21); see Herbert Hochegger, p. 83 seq.

25 Making modifications of the articles of incorporation is a non-transferable power of the shareholders’ meeting according to article 698 para. 2 subsection 1 CO.

26 Concerning the duties of the board cf. article 710a para. 1 CO, especially subsection 3; see Forstmoser/Meyer-Hayoz/Nobel, § 30 note 39 seq.

27 Since filing for reorganization proceedings has momentous consequences on the future of the company and thus on the shareholders’ interests (see footnote 17), the board is hesitant to file for it. Moreover, in order to avoid a damaged reputation, it will try to avoid reorganization proceedings as long as possible. Concerning the relevance of reputation for managers see Hans Caspar von der Crone, Reputationsprozess, p. 29.

28 At this stage, the duties of the board according to article 710a para. 1 subsection 3 CO encompass liquidity planning; see Lukas Glimann, p. 19 seq., p. 34; Lukas Handrich, p. 456 seq.

29 In certain circumstances, a legal duty to initiate reorganization proceedings can be opposed to the duty of the management to attend at the best possible rate to the interests of the company (cf. article 317 para. 1 CO). Therefore, the board of directors should not be legally bound, but entitled to file for reorganization proceedings. File for reorganization proceedings has become a real action alternative in a company’s crisis. Obviously, it is possible that the board of directors abuses this legal change (cf. article 317 para. 1 CO). But, it has to be taken into consideration that the sword of Damocles of bankruptcy still overhangs the responsible persons (see Markus L. Schmid, p. 72). In addition, the management will try to avoid reorganization proceedings as long as possible in order to avoid a tarnished reputation.

30 See article 293 para. 3 DEBA and article 295 para. 1 DEBA. Concerning the creditor ac-
tions, which are not stopped by the stay, see article 297 para. 2 DEBA.

31 See, for example, Lukas Glimann, p. 55 seq.

32 The following authors are of the same opinion: Andreas Feuz, p. 22; Meier/Peyer/Rutschmann, p. 15. Concerning the automatic stay in the U.S. Bankruptcy Code (Title 11 of the U.S. Code; 11 USC §362) and its importance see Warren/Brussel, p. 23, p. 203 seqq. However cf. Expertenbericht, p. 30.

33 The «Cadbury Report» refers to corporate go-

34 See Forstmoser/Meyer-Hayoz/Nobel, § 20 note 1 sec. 1.

35 Cf. the U.S. Bankruptcy Code under which the shareholders participate in the decision-making process (11 USC §1126, 11 USC §501). Under the U.S. Bankruptcy Code, a company may file a voluntary bankruptcy petition regarding the financial condition; Leif M. Clark, p. 1.

36 Whereas, the current law provides only one category of decision-makers at any time: Until the commencement of reorganization proceedings it is up to the shareholders to decide, after that, up to the creditors (cf. article 305 DEBA).

37 Cf. the similar procedure during reorganiza-
tion under Chapter 11 of the U.S. Bankruptcy Code, 11 USC §1129(b) or the critics in the Expertenbericht, p. 30 seq.

38 See Klaus Oesch, p. 36 and generally, Hans Caspar von der Crone, Strategische Leitung und Qualitätssicherung, p. 7 seq.

39 The following authors agree in opinion: Lutz Häussermann, p. 209; Klaus Oesch, p. 89; Meier/Peyer/Rutschmann, p. 15.

40 See NZZ of 16 March 2002, Sanierung als Managementaufgabe/Erste Lehren aus dem Zusammenbruch der San Group, p. 29.

41 If a company is not in reorganization proceed-
ings, on the one hand the shareholders have the power to appoint or dismiss members of the board of directors according to article 698 para. 2 subsection 2 CO and on the other hand the board is entitled to appoint or dismiss members of the executive management according to article 716a para. 1 subsection 4 CO.

42 The term «trustee» means «Sachwalter» according to article 298 para. 1 DEBA.

43 This regulation corresponds with article 716a para. 1 subsection 4 CO (see footnote 41).

44 Cf. article 754 para. 2 CO concerning the re-
sponsibility of the board for the election of the executive management.

45 According to the law in force, the court is entitled to confirm the plan (cf. article 305 DEBA). See the similar provision according to Chapter 11 of the U.S. Bankruptcy Code, 11 USC §1129(b) and Meier/Peyer/Rutschmann, p. 15.

46 The same opinion is represented, for example, by Isaak Meier, Chapter 11, p. 463 and Markus L. Schmid, p. 65.

47 This becomes even more important as the adverse publicity created by the company’s financial crisis typically causes additional liquidity requirements; see Lukas Glimann p. 55.

48 Cf. article 306 para. 2 subsection 2 DEBA. It is often difficult for a company to fulfill this requirement; see Amann/Walter, § 54 note 77.


50 See Meier/Peyer/Rutschmann, p. 15; Andreas Feuz, p. 22; Lutz Häussermann, p. 213.

51 Cf. the similar provision according to Chapter 11 of the U.S. Bankruptcy Code, 11 USC §1129(a)(11).

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Thesen zu einem modernen Schweizer Sanierungsrecht


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