PANORAMIC

DISTRESSED M&A

Switzerland

Distressed M&A

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MARKET CLIMATE AND LEGAL FRAMEWORK

Market climate
How would you describe the general market climate for distressed M&A transactions in your jurisdiction?

After a strong 2022, the first half of 2023 began slower for the entire M&A market. Emerging macroeconomic and geopolitical challenges have resulted in a decrease in investors' risk appetite. In the second half of this year, the general M&A market has started to recover leading to an increase in distressed M&A transactions, as well. The industry will continue to confront obstacles such as macroeconomic headwinds, instability in banking and financing markets, concerns of a recession, and uncertainty in energy prices, many of which are likely to lead to a rising amount of distressed M&A transactions. This may be further accelerated by larger corporations having significant excess cash positions due to the previous period of reduced investment activity.

With regard to industry sectors, we expect ever more acquisitions of companies in the fields of energy, utilities and resources, due to the ongoing energy transition and a general aim towards supply security and diversification. We further believe that pharmaceutical companies will increase acquisitions of smaller companies as part of their pipeline management. In both sectors, many small and medium-sized companies faced difficulties raising funds due to the consequences of investors' decreased risk appetite and rising cost of capital, which is why there remains a steady amount of interesting targets for companies hoping to acquire companies in distress. Last, we noticed an increasing number of court-approved transactions (pre-pack).

Legal framework
What legal and regulatory regimes are applicable to distressed M&A transactions in your jurisdiction?

In Switzerland, M&A transactions are typically structured as share deals or asset deals. In a share deal, the assets, liabilities and contracts generally remain with the target company. The buyer usually also acquires any shareholder loans. In distressed M&A transactions, the purchase price is often effectively paid for the shareholder loans and the shares are acquired only at a symbolic price. In an asset deal, individual assets can be bought out of a company, allowing for cherry-picking. While share deals are predominant in ordinary M&A transactions, asset deals play an important role in distressed M&A transactions. The fact that no debts and uncertainties from the past have to be taken over can be a particular argument in favour of an asset deal. Both types of deals are subject to the legal provisions on the contracts for sales and are therefore based on the Swiss Code of Obligations. The Swiss Merger Act bears significance in the context of corporate restructuring by establishing various rules for the restructuring of companies. These provisions generally also apply to transactions with financially distressed companies, with the speciality that the provisions of the Debt Collection and Bankruptcy Act of 1889, as amended (DCBA), may become relevant.

If a company has been declared bankrupt, the bankruptcy office or an administrator appointed by the creditors may negotiate the sale of assets, either by means of a bilateral sale or in an auction process. Alternatively, companies with growing financial concerns but

realistic prospects for reorganisation can apply for a debt restructuring moratorium. In this case, a court appoints an administrator to oversee the company's reorganisation efforts. In more recent years, Switzerland has seen an uptick in pre-packs, whereby a company in distress applies for a debt restructuring moratorium while at the same time applying for the competent court's approval of a pre-negotiated asset deal regarding the sale of certain assets. Such sale of assets must generally occur at market conditions and be more advantageous for the creditors than the assets of the company concerned being liquidated in bankruptcy proceedings, which is why it requires the approval of the competent court. The advantage of the pre-pack is that the transaction cannot, in principle, be challenged in a subsequent bankruptcy. Therefore, for sellers at risk of bankruptcy, a debt restructuring moratorium and court approval can be of high relevance.

Main risk in distressed M&A transactions

Summarise the main risks to all parties involved.

In a share deal, the buyer runs the risk of acquiring a target with all its liabilities, irrespective of whether these liabilities were known to the buyer, which is why a share deal is often unattractive to buyers looking to acquire companies (or parts thereof) in distress. For both share and asset deals, a vital challenge in any transaction involving a financially troubled company concerns the tight timeframe. Consequently, buyers must often assume a certain level of risk and make expedited decisions, typically resulting in a price adjustment to compensate these risks. In an asset deal, it is, however, crucial for the board of directors to ensure that the assets are sold at a price that is fair, as otherwise both the buyer and the company may run the risk of the deal being challenged in a later bankruptcy proceeding. Directors and officers may further face potential liability claims or even criminal charges if they neglect their duties of care. This is where a pre-pack can offer some security to the parties: if the competent court approves the agreement on the sale of assets in a pre-packaged deal, such deal and the underlying agreement, are protected from being challenged by creditors, even if the company should later fall into bankruptcy.

Director and officer liability and duties

What are the primary liabilities, legal duties and responsibilities of directors and officers in the context of distressed M&A transactions in your jurisdiction?

Swiss corporate law places a strong emphasis on the duty of care and diligence owed by directors and officers, even more so in situations involving financially distressed companies. With Swiss company law having been thoroughly revised with effect from 1 January 2023, the duties of the board of directors in the event of a financial crisis, insolvency of the company, loss of capital or over-indebtedness have even been expanded. In addition to the ongoing duty to monitor the solvency of the company and to take reorganisation measures or even notify the court in the case of insolvency, the board of directors and the management must be cautious when selling assets under value. For this reason, independent third-party valuations or fairness opinions are often obtained.

When considering any M&A transaction regarding the company, it is particularly important that the board of directors complies with these regulations to prevent a possible later action for liability.

Differences from non-distressed M&A

In general terms, what are the key legal and practical differences between distressed and non-distressed M&A transactions in your jurisdiction?

In distressed M&A transactions, the legal framework is influenced by insolvency laws and regulations and may require court approvals pertaining to insolvency proceedings. The primary goal is often to maximise the value of the distressed company's assets for the benefit of creditors while complying with the DCBA and other relevant laws. Directors of distressed companies are obliged to concurrently consider the interests of both shareholders and creditors, adding a layer of complexity to due diligence, which must be conducted expeditiously.

Conversely, in non-distressed companies, the focus is on shareholder interests, and the transaction can be structured to meet the objectives of the involved parties. Valuation is generally more straightforward, often considering prevailing market conditions or merely party negotiations, and the transactions tend to adhere to a more foreseeable timeline.

Timing of transactions

What key considerations should be borne in mind when deciding when to acquire distressed companies or their assets?

The most crucial factor for a buyer looking to acquire a distressed company or its assets will likely be transactional security. Due to Swiss insolvency law, any deal with a company in distress, even if it is made prior to the initiation of insolvency proceedings, bears the risk of being challenged or even reversed in such later proceedings. Thus, while an out-of-court deal may appear to have the advantages of less strict timing and more flexibility for the parties, careful consideration is required by both parties. In the course of bankruptcy or debt restructuring moratorium proceedings, the buyer may need to compromise on timing, as these scenarios typically involve a larger number of stakeholders and can entail more complex negotiations.

TRANSACTION STRUCTURES AND SALE PROCESS

Common structures

What sale structures are commonly used for distressed M&A transactions in your jurisdiction? What are the pros and cons of each, and what procedures and legal requirements apply?

Like regular M&A transactions, deals involving distressed companies can be carried out in the forms of share deals, asset deals or any other transactions allowed under Swiss law. While a share deal is relatively easy to implement, it is the continued existence of all (known and

unknown) liabilities that makes the share deal in distressed M&A transactions less attractive for buyers. In contrast, an asset deal allows the buyer to cherry-pick the desired assets and leave behind any unwanted liabilities. In this context, the challenges are determining an appropriate price for the desired assets, avoiding the legal transfer of unwanted employee contracts and debts, and avoiding the risk of contestation in bankruptcy. Depending on the industry, it may further be possible for a company in distress to license out its assets and reduce its own operations to a minimum to turn the company around in the medium to long term.

The Swiss Federal Supreme Court has relatively recently ruled that pre-packs are, in principle, permissible, making a pre-packaged asset deal an attractive option for distressed transactions.

Packaging and transferring assets

How are assets commonly packaged and transferred in a distressed M&A transaction in your jurisdiction? What procedural, documentary and other requirements apply?

When the possibility of successfully restructuring a company diminishes, a common practice is to sell the company's business, or certain parts of it, through an asset sale to a newly incorporated company. Typically, this occurs in one of two ways: either as an out-of-court transaction (carve-out) prior to any formal insolvency proceedings, or within the framework of a debt restructuring moratorium, often in the form of a pre-pack. In instances where the board of directors initiates a debt restructuring moratorium and seeks to sell the business to an acquisition company during this moratorium period, the approval of the court is necessary. This approval can be sought concurrently with the application for the provisional moratorium, particularly if the urgency of the sale is paramount to prevent a loss of value and if the company was able to pre-negotiate such asset deal in advance. As part of the application for a provisional debt restructuring moratorium, a (draft) purchase agreement must be submitted, outlining the details of the business's sale to the newly incorporated company. The agreement can be either a draft or a completed agreement with a condition of approval by the court. This approach allows for a structured and legally compliant process to transfer the company's assets to a new entity, often ensuring the continuity of operations and preserving value in distressed situations, whereas, in the case of a conventional bankruptcy proceeding, assets are on the balance sheet of a company are re-valued at liquidation values, which can have a significant negative impact on the valuation of IP, for example. Another big advantage lies in the additional transactional security, as asset deals approved by the court are protected from a challenge in possible later insolvency proceedings.

Transfer of liabilities

What legal requirements and practical considerations should be borne in mind regarding the acceptance and transfer of any liabilities attached to the distressed company or assets?

In a share deal, where a buyer acquires 100 per cent of the shares of the target, all assets and liabilities remain with the target and full ownership is transferred to the buyer. In the case of

a sale of assets of a distressed company, the board of directors must ensure that the sold assets do not serve as collateral for liabilities unless these liabilities are transferred to the buyer, as well. The transfer of liabilities is usually not desired, as a transfer of only selected liabilities may potentially favour certain creditors over others, opening the transaction and the directors and officers up to liability claims. Only the assumption of privileged claims (such as employee claims) and secured debt may be considered safe, as these liabilities would also be satisfied prior to other creditors in bankruptcy proceedings.

Consent and involvement of third parties

What third-party consents are required before completion of a distressed M&A transaction? What are the potential consequences of failure to obtain these consents? In what other ways are third parties commonly involved in the transaction?

While in theory, prior to any insolvency proceedings or a debt restructuring moratorium, no additional approvals are necessary to facilitate a legal sale and transfer of the business, in practice, it is common for the primary creditor or creditors of the company to be actively engaged in the transaction. This involvement serves to mitigate the risk of potential challenges to the transaction in subsequent bankruptcy proceedings. An independent valuation of the business or its assets may provide for additional security in both share and asset deals. In addition, the consent of the contracting party is required if any agreements are transferred in addition to the assets in an asset deal. If, exceptionally, debt is assumed, the consent of the creditor is also required.

Any pre-packaged sale of assets as part of a debt restructuring moratorium will require the approval of the court and may be applied for concurrently with the application for a provisional debt restructuring moratorium. The consent of secured creditors will be required for a release of security interests.

Conversely, in scenarios where bankruptcy proceedings have already been initiated, the sale of the company's business falls under the purview of the bankruptcy officer or the appointed administrator. This sale can occur either through an auction process or, in cases of urgency, as a single-buyer sale, all carried out in the best interests of the creditors.

Time frame

How do the time frames and timelines for the various transaction structures differ? Can these be expedited in any way?

Pre-packaged sales of a company's business or parts thereof can theoretically be facilitated fairly quickly but depend on the workload and speed of the competent court. While such deals have been successfully made within less than one month after submitting the provisional debt-restructuring moratorium request including the pre-negotiated purchase agreement to the relevant court, other deals require significantly more time. The timeline for a sale within a bankruptcy proceeding is often considerably longer and depends on the administration involved.

Tax treatment
What tax liabilities and related considerations arise in relation to the various structures for distressed M&A transactions in your jurisdiction?

Generally speaking, the tax rules remain consistent whether dealing with a distressed or non-distressed M&A transaction However, special tax advantages may be accessible in distressed scenarios.

In the rare event of a share deal involving a distressed target, there will usually be no direct tax consequences on the level of the target itself resulting from the sale of its shares. Any losses carried forward remain with the target and may potentially be offset against future profits.

In an asset deal (pre-packs included), the distressed company would realise its hidden reserves which could typically be offset against existing losses carried forward. Consequently, such capital gains would not trigger corporate income tax obligations, provided that the gain can be fully balanced by such losses. On the level of the shareholders, proceeds from the asset sale may be qualified as a liquidation dividend and thus be subject to (usually reclaimable) withholding tax. Different rules may apply to real estate property transactions.

In distressed M&A share deals, a major concern is restructuring debt to help the struggling company. In this regard, it is worth noting that contributing money without compensation may result in a 1 per cent tax if no exemption applies. Waivers of claims are generally taxable at the level of the company benefitting from such waiver, but there are various exceptions that must be considered in each individual case.

Auction versus single-buyer sale process
What are the respective pros and cons of auction sales and single-buyer sales? What rules and common practices apply to each?

In distressed M&A transactions, auction sales offer competitive bidding, transparency, and a potential for higher prices. The resulting price will more often be considered a fair market value and thus provide additional security against later challenges. At the same time, auctions involve uncertainty over the final price and associated costs and usually require significant organisational efforts and large amounts of time. Single-buyer sales provide negotiation flexibility and deal certainty but may lack competitiveness, extend the timeline, and carry the risk of deal failure. The choice depends on the seller's goals, buyer interest, and urgency, with legal and financial advisors playing a pivotal role in decision-making. Both types of sales can be organised and executed by the company and do not differ from regular M&A transactions if done before the commencement of any insolvency proceedings. During bankruptcy proceedings, the Debt Collection and Bankruptcy Act of 1889, as amended provides for detailed regulations on both types of sales.

DUE DILIGENCE

Key areas
What are the most critical areas of due diligence in a distressed M&A transaction?

With companies in distress, there is often little time to conduct a full due diligence and only limited access to due diligence material. Coupled with the tight timetable mentioned earlier, this requires the buyer and its advisors to focus on the critical issues and more material risks such as financials, change of control provisions, legal implications of distress, employment issues, and intellectual property rights.

Searches
What searches of public records should be conducted as part of a due diligence exercise in distressed M&A transactions in your jurisdiction?

Due to the anonymous nature of Swiss stock corporations, there is usually only limited information publicly available. It is, however, usual to examine the Swiss Commercial Register to obtain details about the target company's legal existence and structure, its share capital, registered address and any historical changes in corporate information. This also includes reviewing the company's articles of association, which have fairly recently become easily accessible online for most cantons. Another key public record is an excerpt from the debt collection register and the retention of title register. Reviewing bankruptcy and insolvency registers to identify the ongoing or historical insolvency proceedings involving the target company is essential for assessing the extent of financial distress. Additionally, public announcements and notices such as in the Swiss Official Gazette of Commerce should be taken into account. Depending on the company's assets, it may also be imperative to assess the Real Property Register and the Intellectual Property Register. These additional searches can provide valuable insights into the target company's real estate holdings as well as any intellectual property assets.

Contractual protections and risk mitigation
What contractual protections and other strategies are commonly used to mitigate diligence gaps in a distressed M&A transaction?

It is common for buyers of distressed businesses outside of insolvency proceedings to accept the associated risks arising from diligence gaps and offset these risks against the typically lower purchase price offered by sellers in distressed situations. In such cases, warranty and indemnity insurance is often not available as a means to mitigate these risks because the lack of thorough due diligence can result in policy exclusions.

VALUATION AND FINANCING

Pricing mechanisms and adjustments
What pricing methods, adjustments and protections are commonly used in the valuation of distressed M&A transactions in your jurisdiction and

what are the pros and cons of each? How are they used to balance the interests of the parties?

The value of the target company, typically assessed as its enterprise value, is often determined using the discounted cash flow method or relying on multiples. However, other valuation methods may be employed by the parties, sometimes depending on the industry sector of the target. If the company hardly generates any cash flows (eg, a start-up company), the book value or the costs incurred are sometimes taken into account as the basis for setting the price. The actual purchase price for the target company is then negotiated between the parties based on this valuation.

Both locked box and closing accounts mechanisms are commonly used in Switzerland; however, in distressed M&A transactions, parties often opt for the locked box mechanism, especially when there is a short period between the balance sheet date and the closing date (typically in the first or second quarter), or when an audited interim balance sheet is available. While earn-out mechanisms are commonly used in regular M&A transactions, such provisions usually do not fit the typical structure of an asset deal involving a distressed company.

Fraudulent conveyance

What rules govern fraudulent conveyance of distressed assets sold undervalue in your jurisdiction? How can clawback risks be mitigated when negotiating the deal price?

This is one of the main risks when acquiring a company in financial distress. According to article 285 et seq of the Swiss Debt Enforcement and Bankruptcy Act, assets can be subject to enforcement if they have been removed from the company through legal actions specified in articles 286–288. These actions include gifts, undervalued asset transfers, payments of claims using unusual means, securing claims without obligation at the time of over-indebtedness, and intentional actions aimed at disadvantaging specific creditors. Since these risks are often challenging to assess, the parties typically try to enter into a pre-pack agreement and proceed with the sale subject to the approval of the court.

Financing

What forms of financing are available and commonly used in distressed M&A transactions? How can financing be secured?

Financing options in distressed M&A transactions are similar to those in non-distressed deals. Strategic investors will usually opt for cash payments when acquiring distressed assets. The choice of financing is often determined by the transaction’s timeline and the buyer’s financing structure.

Pre-closing funding

What provisions are typically agreed to secure pre-closing funding of distressed businesses and assets?

Due to the target companies usually already being in distress, bank financing is often unattainable if the company does not have any unencumbered assets to use as collateral. Distressed companies often resort to the financial resources of the shareholder, venture debt loans at disadvantageous conditions (which is not in the interest of the buyer) or bridge financing by the buyer, which may later be offset against the purchase price in the case of an asset deal. The parties will usually aim to enter into negotiations before the target company is completely insolvent and avoid the necessity for additional funding by expediting the envisaged deal.

DOCUMENTATION

Closing conditions

What closing conditions are commonly agreed in distressed M&A transactions? How do these differ from non-distressed transactions?

Due to heavy time constraints in distressed M&A deals, closing conditions are typically kept to a minimum and will primarily include the approval from the composition court in the case of pre-packaged deals. Further conditions may include obtaining regulatory and (or) lender approval, if applicable. If lender approval is necessary, it is typically obtained before or at the same time as entering into the transaction agreements.

Other provisions typical to non-distressed transactions such as material adverse change clauses are seldom used in distressed M&A deals. Due to an inherent high level of uncertainty being the basis of distressed M&A transactions, any additional variables are usually priced in.

Representations, warranties and indemnities

What representations, warranties and indemnities are commonly given in distressed M&A transactions?

Transactions made prior to any insolvency proceedings or debt restructuring moratorium will rely on similar representations, warranties and indemnities as regular M&A transactions. However, due to time often being a critical factor, due diligences are usually limited to red flags, if conducted at all, and buyers will be left taking on part of the risk against a discount on the purchase price. In addition, representations and warranties within an asset deal will usually only be useful to the buyer if the seller is and remains solvent and financially stable. Therefore, it is especially relevant in distressed M&A transactions to critically question who is giving the representations, warranties and indemnities, if any.

No representations and warranties as well as indemnities are usually given in the course of any sale during insolvency proceedings or debt restructuring moratoriums.

Remedies for breach

What remedies are available and commonly sought for breaches of closing conditions, representations, warranties and indemnities in distressed M&A transactions?

In the case of non-compliance with closing conditions, the entitled party can usually withdraw from the purchase agreement. However, in distressed M&A deals, parties typically aim to reduce the risk of failure to meet closing conditions by minimising the time between signing and closing.

In the event of breaches of representations and warranties or in the event of an obligation to indemnify the buyer, the buyer is usually entitled to compensation. In the case of share deals, direct claims against sellers are frequently excluded. Buyers are often required to assume some of the risk, but may profit from a lower purchase price.

Insurance

Is warranty and indemnity (W&I) insurance available for distressed M&A transactions in your jurisdiction? If so, what provisions and exclusions are commonly included in W&I policies?

While W&I insurance is now a common feature in regular M&A deals, costs are relatively high and insurers often require a customary due diligence and disclosure process for extensive coverage. Due to time and cost constraints, obtaining such insurance is often not feasible in distressed M&A scenarios.

REGULATORY AND JUDICIAL APPROVALS

Merger control

What merger control rules and filing requirements govern the acquisition of distressed businesses and assets in your jurisdiction? Is the 'failing firm' defence recognised in your jurisdiction?

The Swiss merger control regime is governed primarily by the Federal Act on Cartels and Other Restraints of Competition (Cartel Act) and the Ordinance on the Control of Concentrations (Merger Control Ordinance). Under Swiss law, mergers or acquisitions are subject to merger control if they lead to a significant impediment to effective competition in Switzerland. To determine whether a merger or acquisition meets this threshold, the Swiss Competition Commission assesses various factors, including market share, market concentration, and the effects on competition. In distressed M&A scenarios, merger control requirements in Switzerland remain unchanged.

Switzerland recognises the 'failing firm' defence concept, which can be applied by the competition commission to justify a merger and (or) acquisition of a company facing financial distress and potential insolvency. The acquiring party needs to demonstrate that, without the acquisition, the distressed company would exit the market and its market share would be lost to competition anyway. There must further be no solution less harmful to competition than the acquisition of the distressed target.

Foreign investment review
Are distressed M&A transactions subject to foreign investment review in your jurisdiction? What rules, procedures and common practices apply?

There are currently no general restrictions on foreign investment in Switzerland on the basis of national interest or security with the exception of real estate holding companies. However, in March 2020, the Swiss parliament passed Motion 18.3021 Rieder, which tasked the Federal Council with creating a legal framework for reviewing foreign investments in Switzerland. The Federal Council is currently working to implement this mandate. On 18 May 2022, it initiated a public consultation for an Investment Review Act, which concluded on 9 September 2022. On 10 May 2023, the Federal Council received the results of the public consultation regarding the Investment Review Act. There is widespread scepticism about the proposal, particularly as it may weaken Switzerland's attractiveness as a business location. Consequently, the Federal Council has instructed the Federal Department of Economic Affairs, Education and Research to develop a proposal by the end of 2023 that focuses on investments critical to national security

Bankruptcy court
What rules and procedures govern the bankruptcy court's approval of distressed M&A transactions in your jurisdiction?

The sale of assets during bankruptcy proceedings is meticulously governed by the Debt Collection and Bankruptcy Act of 1889, as amended (DCBA) and its related regulations. There are two main procedures that can be employed: auctions and single-buyer sales. Auctions, as specified by the DCBA, adhere to stringent regulations, with most sale elements determined by the bankruptcy officer or appointed administrator, making them unsuitable for selling entire businesses. Consequently, auctions under the DCBA are infrequently utilised. On the other hand, single-buyer sales in bankruptcy proceedings have relatively few statutory guidelines and often resemble out-of-court sales. Notably, in single-buyer sales governed by bankruptcy law, no warranties are provided.

DISPUTE RESOLUTION

Common disputes and settlement
What issues commonly give rise to disputes in the course of distressed M&A transactions and what practical considerations should be borne in mind when seeking to settle such disputes out of court?

While the main risk in M&A transactions is proceedings caused by the breach of representations and warranties, in distressed M&A transactions, such guarantees are rarely given, which limits the number of disputes. If a sale occurs within a bankruptcy process, the buyer must be aware of the distressed company's creditors, which might contest the sale. For pre-packaged deals as part of a debt-restructuring moratorium, challenging the transaction gets more difficult for the creditors due to prior approval by the court.

Litigation and alternative dispute resolution

What litigation forums are used to resolve disputes arising from distressed M&A transactions in your jurisdiction and what procedures apply? Is alternative dispute resolution (ADR) commonly used?

There is no difference in resolving disputes arising from distressed M&A transactions compared to non-distressed M&A transactions. Alternative dispute resolution is possible, whereas such proceedings are rarely used. Disputes arising from a transaction within bankruptcy proceedings are usually handled by state courts, typically located where the bankrupt company has its registered office. Swiss law is applicable unless the parties have declared the law of another country to be applicable.

UPDATE AND TRENDS

Recent developments and outlook

What have been the most significant recent developments and trends affecting distressed M&A in your jurisdiction, including any notable court decisions, regulatory actions and deals? What is the general outlook for future transactions?

Ever since the relevant leading decision of the Federal Supreme Court (BGE 5A_827/2019) of 18 March 2021, no major decisions have been issued at the federal level specifically in connection with distressed M&A transactions.

On a macroeconomic level, it is noticeable that higher interest rates, tighter financing conditions and investors' low-risk appetite have led and may continue to lead to more and more start-up companies encountering financial difficulties.

In the European Union, the European Commission published a proposal in December 2022 for a directive seeking to harmonise insolvency legislation of EU member states focusing, among others, on pre-pack sales, which may be autonomously implemented in the near future in Switzerland, too.