NewsLetter LL

Information by the Law Offices of Lutz Rechtsanwälte

Rescue Operations can be Avoided with Timely Measures by the Board of Directors

Dr. Peter Lutz

The global economic downturn has had a massive impact also on the Swiss economy. In this difficult environment, the boards of directors of small and medium-sized enterprises are also confronted with new challenges. What measures should be implemented urgently in order to secure the continued existence of the company?

Information

Precise and timely information is of crucial importance in times of crisis. Boards of directors must keep a much closer eye on the operational business. As fast action is often required, very precise information is indispensable for the implementation of targeted and efficient measures.

Month-end statements should be available within just a few days after the end of the month. Relevant operational key figures, specifically as regards the liquidity situation, must be submitted on a weekly basis.

The members of the board of directors should also exchange information and opinions on an informal basis. Nobody should insist on compliance with ten-day or twenty-day periods of notice of a meeting. Telephone conferences, the exchange of information by e-mail and discussions arranged at short notice should be possible. The tasks must be defined clearly, even when things get hectic, and all decisions must be recorded. In such times in particular, the chairman of the board of directors must make sure that the minutes of meetings are kept simple but that all decisions are minuted clearly.

The exchange of information with the operational management must be intensified. The operational management is in the best position to compile, prepare and communicate the relevant information as regards the company's situation, the market trends and the conduct of the company's competitors.

Status reports and decision-making

Given the changed circumstances, the board of directors should think about whether a change in strategy is required, or whether a few adjustments to the strategy will be sufficient. This decision must be based on an analysis of the current situation, and in particular the factors that have changed. Also doing nothing can be a decision, but such a decision must be taken consciously.

Issuing instructions

The line of approach and interim objectives must be clear to the operational management. However, the board of directors must take care not to interfere too much in the management of the company and to respect the separation of functions. Micro-management is unwelcome, especially in times of crisis.

Contingency planning

The board of directors must think in terms of scenarios. For example, it should think about the impact that a drop in sales of 20% would have on the various divisions of the company. Contingency measures for this scenario must be formulated, and these measures must be scheduled for specific dates.

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The board should in particular investigate whether strong, viable business divisions should be outsourced in order to relieve them of the burden of legacy issues facing contaminated divisions.

The question should be asked as to whether entire business divisions should be closed down or at least reduced to minimum capacity for the time being.

Implementation and monitoring

In hectic times many decisions are taken but their implementation is not monitored closely enough. The board of directors is responsible for checking whether decisions have been implemented and have the desired effect. If they have not been implemented, the board must enforce their implementation. If the measures are ineffective, alternatives should be investigated.

Individual measures

Capital: The supervisory body must ensure that the company has sufficient capital. Once the crisis has struck it is almost impossible to find additional capital, and when it can still be found, the conditions are very unfavourable.

Sales: The company should focus on customers and market segments that are not too badly affected by the crisis.

Personnel and overhead costs: Employees could be requested to use up their vacation and overtime credits. Unpaid leave could be enforced. All expense items must be investigated to make sure that the related services are absolutely essential. A strict plan of cutting all unnecessary costs must be followed.

Accounts receivable: A consistent process of sending out reminders must be implemented. Before an order is accepted, the effect of the crisis on the counterparty and the latter's liquidity situation must be carefully assessed. Advance payments and down payments should be introduced.

Inventory: The inventory should be reduced.

Investments: Leasing instead of buying. Investments should be reconsidered before being approved. Divestments should be considered.

Accounts payable: Payment terms should be renegotiated whenever possible. Lender banks should be contacted at an early stage and relationships with the banks should be nurtured.

Conclusion

By implementing measures based on accurate information in a timely manner, the board of directors can avoid difficult situations for the company. In this way the need to handle even more difficult issues at a later stage, and in particular issues related to personal liability, can be avoided. ■

In our case

We are happy to inform you that **Christopher Tillman LL.M. (Exeter UK), Certified Specialist SBA Construction and Real Estate Law,** became a **partner** in our law firm. With Christopher Tillman on board, our law office will expand and strengthen its activities and subject expertise in the fields of private and public building and property law and rental law in the residential, industrial and project building industry. ■

Duties of the Board of Directors in Crisis Situations

When a company is suffering from a crisis, Art. 725 of the Swiss Code of Obligations soon takes centre stage. This article introduces a two-stage security concept, the effect of which is determined by the ratio between the value of the company's assets and the borrowed capital. Often the board of directors does not have the required objectivity when assessing the financial situation of "its" company and thus fails to act in compliance with this provision, which means that it could be confronted with liability claims by creditors in the event of bankruptcy.

According to law, the board of directors (BoD) must convene a general meeting (GM) without delay and propose restructuring measures if the last annual balance sheet shows that half of the share capital and the legal reserves are no longer covered (Art. 725 par. 1 Swiss Code of Obligations (SCO)). If there is reason to be worried about overindebtedness, an interim balance sheet must be drawn up and the judge must be informed if the claims of the company's creditors are no longer covered, either if the company is valued on a going-concern basis or at its realisable value, and the company's creditors do not agree to subordinate their claims for the amount of the cover shortage (Art. 725 par. 2 SCO).

Restructuring measures must be instigated at an early stage

Contrary to the wording of Art. 725 par. 1 SCO, it is (not only) the figures in the last annual balance sheet that determine whether restructuring measures should be requested, but also the internal figures that are available to the BoD before the audit of the annual accounts. If necessary an extraordinary GM must be convened, unless the fact that the ordinary GM will take place soon enough means that this will not serve any purpose but will only trigger additional costs. The figures that reflect the value of the company on a going-concern basis apply. Legal doctrine for the most part dictates that, if a company has a deficit balance with current losses, the BoD has the same type of financial responsibility as in the case of overindebtedness pursuant to Art. 725 par. 2 SCO, i.e. if there is "reason to be concerned that half of the company's capital may have been lost", the BoD must order the preparation of an interim balance sheet and convene a GM to approve restructuring measures if necessary. It can be agreed with Böckli that the trend is towards "bringing forward the time when the alarm is sounded from that which the legislator prescribed in Art. 725 SCO based on the state of knowledge in the 19th century."

Art. 670 SCO gives the BoD the option to initiate legally approved balance sheet arithmetic: if there is a cover shortage real estate and investments where the current value is more than their purchase cost can be revalued upwards up to the current value in order to eliminate the deficit balance. In some cases the BoD then does not have to convene a GM and request approval for restructuring measures.

Restructuring

Under Art. 725 par. 1 SCO the BoD has a duty to prepare restructuring measures, convene a general meeting to approve these measures, explain the restructuring measures and obtain authorisation to implement these measures. Although the primary purpose of a restructuring programme is to solve a company crisis, it must also ensure that the company will recover in the long term. If this does not seem possible, it might be necessary for the BoD to propose the liquidation of the company or another measure that will end the company's independence.

Dr. Christian Christen

If a capital restructuring is required, the following measures, among others, take centre stage: capital writedown (reduction of share capital followed immediately by a share capital increase), share capital increase involving a debt/equity swap, the addition of new money or a waiver of debts outstanding by the sole or major shareholder. Restructuring measures aimed at the recovery of the company always involve – in addition to

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the operational measures - the addition of new money to the company. If this is not the case, it cannot be excluded that the BoD can, during any later bankruptcy proceedings, be accused of taking measures that simply extended the patient's suffering although the inevitable end had already been in sight.

Reasonable concerns about overindebtedness

If a company does not move directly into overindebtedness but first goes through a separate process where it loses half of its capital, the BoD is already obliged to exercise more vigilance as regards the company's financial circumstances. It is seldom enough for the BoD to just monitor the usual balance sheet items if it wishes to comply with Art. 725 par. 2 SCO. Rather it must keep an eagle eye on the cash outflow, any deterioration in the cash flow statement, unfavourable reactions by the lender banks, or the updating of joint and several liability and contingent liability agreements. The more acute the cash shortage, the more reason to be concerned about overindebtedness.

In this situation, the BoD must draw up an interim balance sheet based on going-concern values as well as an interim income statement for the current financial year up to the selected reference date. If it is confirmed that the company is overindebted, a balance sheet at realisable values must also be drawn up as of the reference date. Assets must be measured at their estimated fair value and liabilities must include provisions for shut-down costs and realisation costs. The accounts must be submitted to the auditors for an audit. This provision stems from the legislator's wish that the auditors should intervene if the board of directors should be too optimistic about the company's situation. If the balance sheet at going-concern values includes substantial hidden reserves it could be possible that the borrowed capital is still covered by the company's assets according to the liquidation balance sheet. However, restructuring measures will almost always be required in such a situation.

Subordination

Subordination is a possible last way out of the dilemma if overindebtedness has been confirmed: a creditor promises that, if the company should go bankrupt, it will only demand settlement of its claim after the debts of all other creditors have been settled, i.e. the claim is subordinated "to the extent of the cover shortage". It is not clear what form this should take. Opinions range from the extent of the overindebtedness, depending on the situation according to the liquidation or going-concern balance sheet, up to the amount at which 50% of the share capital is covered again. A range of between 10% and 20% of the share capital seems appropriate.

If no subordination is granted, legal practice grants the BoD a period of grace of several weeks following the confirmation of overindebtedness to find a radical short-term solution. However, this process is not without its risks, at least if there are no tangible signs that a rescue is possible, because the creditors will mostly take the point of view that the waiting worsened the overindebtedness and that the BoD is responsible for the losses caused by this delay.

(Cold) comfort is given by the fact that a breach of duty alone is not sufficient to establish the directors' liability under company law pursuant to Art. 754 et seq. SCO. Rather, it must be adequately proved that a breach of duty was the direct cause of a loss that can be computed exactly. If the BoD fails to carry out certain duties, it must be proved that if they had carried out these duties, a loss that can be computed exactly would not have occurred. Trying to get past this procedural hurdle usually requires a lot of staying power on the part of the plaintiff. ■

What Must be Settled Before Death?

Nobody likes to think of death, and certainly not of their own death. It nevertheless still makes sense to make arrangements for your death, as those who think about the consequences of their own death can ensure peace of mind for themselves and their dependants. In addition to settling material issues, other questions must also be answered, such as whether you need a living will, or the type of funeral you wish to have.

von Irène Biber

1. Will and inheritance contract

As far as the distribution of the estate is concerned, the Swiss Civil Code (SCC) only prescribes the minimum shares which the future testator may not distribute. These are called the compulsory portions. The rest of the estate can be distributed in accordance with the testator›s wishes, either by a will or an inheritance contract. Both are testamentary dispositions, i.e. the testator determines what should happen to his assets after his death. For example, some legal heirs can be given more than other legal heirs, other persons can be appointed as heirs, and bequests can be made.

Both the will and the inheritance contract must comply with strict formal requirements, i.e. the inheritance contract must be made by public deed, and the will must be written out by hand by the testator.

In contrast to the will which can be revoked at any time, the inheritance contract can only be revoked with the consent of the other contracting parties. The inheritance contract can only be revoked unilaterally if the heir or beneficiary is guilty of conduct that is cause for disinheritance or if he breaches the contract.

Not every testator can choose between a will and an inheritance contract. For example, a child can only be recognised and an executor can only be appointed by way of a will, while a future inheritance can only be renounced by way of a contract of inheritance.

Possible and frequently practiced is the combination of a will and a contract of inheritance. The parties can include the testamentary appointment of an executor in their inheritance contract. Because of its testamentary nature, this provision can be revoked individually by each of the contracting parties.

It is important that the will is found quickly after someone's death. It can be kept at home or given to a confidant for safekeeping. The confidant can also be given just a copy. With an inheritance contract and a public will, the notary public is responsible for the official safekeeping of a copy.

2. The executor

If the testator wants to be sure that his wishes will be carried out, he can appoint an executor. This can be one of the heirs, a legatee or a third party who is not involved in the estate. It is also possible to appoint several persons as executors, with the testator allocating different tasks and powers to each of the executors. The testator can also appoint a substitute executor. The executor is responsible for all aspects of the estate until the entire estate has been distributed. He must, for example, pay all the estate›s debts, pay out the bequests, manage the estate and prepare its distribution in accordance with the testator›s instructions. The executor is the only person with access to the estate.

But what happens if the heirs are not happy with the executor? Unfortunately, it is more difficult to get rid of him than they would sometimes wish. The SCC makes provisions for the supervision of an executor and in some cases the dismissal of an executor, but this is subject to strict conditions. The executor can only be dismissed if it can be proved that he is guilty of something such as the culpable delay of the proceedings, that there is a conflict of interests or that he is unable to exercise of his office. This is why the testator should think carefully about whom he wishes to appoint as executor. This choice should depend, apart from an unimpeachable character, on training and sufficient experience.

3. The living will

A living will can set out what should happen if you are no longer in a position to express your wishes. The living will makes it easier for family members and doctors to take difficult decisions in difficult times. The living will can deter-

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mine treatment in the terminal phase as well as what should happen with the body after death, including the donation of the organs. The living will can also determine who should be given information by the doctor, who may inspect the case history after death, and who should be notified in an emergency.

Here too it is important that the living will is found in good time. It therefore makes sense to keep the original at home and to give copies to the family doctor and a confidant.

4. Organisational issues

Organisational issues such as the funeral can also be included in the will. They can also be set out in a separate document, for example a document titled "What to do in the event of my death". The funeral can be described in detail, for example with instructions regarding the letter announcing death, the obituary notice, whether the body should be cremated or buried, the type of grave, the funeral service, and other wishes. Such a document makes things easier for the family and eliminates the need for many discussions.

Conclusion

We should all prepare for our own death and its consequences as much as possible. Those who take care of everything in good time save their family much unpleasantness, which is a good thing in view of everything that has to be done when someone dies. ■

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Humor

Trial. A small town prosecuting attorney called his first witness to the stand in a trial, a grandmotherly, elderly woman. He approached her and asked, "Mrs. Jones, do you know me?"

She responded, "Why, yes, I do know you Mr. Williams. I've known you since you were a young boy. And frankly, you've been a big disappointment to me. You lie, you cheat on your wife, you manipulate people and talk about them behind their backs. You think you're a rising big shot when you haven't the brains to realize you never will amount to anything more than a two-bit paper pusher. Yes, I know you."

The lawyer was stunned. Not knowing what else to do he pointed across the room and asked, "Mrs. Williams, do you know the defense attorney?"

She again replied, "Why, yes I do. I've known Mr. Bradley since he was a youngster, too. I used to baby-sit him for his parents. And he, too, has been a real disappointment to me. He's lazy, bigoted, he has a drinking problem. The man can't build a normal relationship with anyone and his law practice is one of the shoddiest in the entire state. Yes, I know him."

At this point, the judge rapped the courtroom to silence and called both counselors to the bench. In a very quiet voice, he said with menace, "If either of you asks her if she knows me, you'll be jailed for contempt!"

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