International Briefings

The changes introduced by FINSA are to be welcomed. They will help to increase the transparency of ITOs by requiring the issuer to disclose a similar level of information, which today is expected when issuing listed securities. Moreover, the *ex-ante* control of prospectuses will ensure that ITO documentation falling below the regulatory standard, is not admitted to the Swiss market of tokenized securities. Switzerland, which has recently announced its intention to become the leading "Crypto-Nation", can only benefit from these regulatory developments that will help to create a more mature ITO and blockchain market. ■

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DEAD MAN WALKING: INSOLVENT TRADING UNDER SWISS LAW

Like many other jurisdictions, Switzerland has rules against insolvent trading, which are aimed at safeguarding the interests of creditors of corporations in financial difficulty. Under the Swiss conception, insolvent trading is the act of a corporation continuing to trade in circumstances where its board of directors has failed to file for bankruptcy despite being obliged to do so. This briefing provides an overview of the notion and the consequences of insolvent trading under Swiss law. An emphasis is put on the question of whether financial creditors can be held liable for their debtor's insolvent trading.

OVER-INDEBTEDNESS AS INSOLVENCY TRIGGER

Swiss corporate law obliges a corporation's board of directors and its auditors to take action if the erosion of the corporation's assets through sustained losses reaches certain levels of severity. The relevant levels are the occurrence of a loss of capital and over-indebtedness.

If the corporation's year-end standalone balance sheet shows that half of the aggregate amount of its share capital and statutory reserves are no longer covered by its assets (loss of capital), the corporation's board of directors is obliged to immediately convene a general meeting of shareholders and to propose restructuring measures at such meeting. If a corporation's board of directors has or should have reason to believe that the corporation's liabilities exceed its assets, it is obliged to immediately prepare an interim balance sheet at going concern and at liquidation values and to have it audited by a certified auditor. If that interim balance sheet shows that the corporation's liabilities exceed its assets at going concern as well as at liquidation values, then the corporation is over-indebted and its board of directors is obliged to file for bankruptcy with the competent court, unless one of the following exceptions applies. The first exception is that creditors with claims in an aggregate amount no lower than the amount of the corporation's over-indebtedness subordinate their claims against the claims of all other creditors. The second exception is that there is a substantiated likelihood for an informal, ie out-of-court, workout within a relatively short period of time. It is not settled in Swiss case law as to how long such period of time is supposed to be. However, many legal scholars consider such period to be four to six weeks. As an alternative to filing for bankruptcy, the corporation's board of directors may apply for the opening of composition proceedings, the Swiss version of a court-supervised corporate rehabilitation procedure.

While the criterion of over-indebtedness is based on a balance sheet test rather than a liquidity test, it is important to note that a corporation's inability to pay its debts as and when they fall due within the next twelve months will cause the corporation to lose the going concern assumption for accounting purposes and lead to an obligation to account for liquidation values only. This, in turn, will typically result in over-indebtedness because the corporation's assets are usually worth less at liquidation values than at going concern values.

The obligation to file for bankruptcy is on the board of directors in its entirety and the board's decision is subject to the internal rules on decision making. While the action of filing for bankruptcy can be delegated to individual directors, an individual director does not have the power to file for bankruptcy without prior authorisation by the board of directors. In addition to the board of director's obligation to file for bankruptcy, the corporation's auditors are obliged to notify the bankruptcy court if the board of directors has failed to file for bankruptcy despite the corporation being obviously over-indebted. Neither a shareholder of the corporation, nor its management, nor its creditors have a right to file for bankruptcy on behalf of the corporation. However, any individual creditor of a corporation has the ability to force the corporation's bankruptcy through debt enforcement proceedings, provided that certain conditions are fulfilled. Moreover, a corporation's shareholders' meeting may declare the corporation illiquid, based on which its board of directors must file for bankruptcy.

DIRECTORS' PERSONAL LIABILITY FOR INSOLVENT TRADING

Directors are subject to personal civil liability for damages for any losses caused by insolvent trading. Insolvent trading is the act of a corporation continuing to trade in circumstances where its board of directors has failed to file for bankruptcy despite being obliged to do so. In order to determine damages, a court will typically compare the hypothetical amount of the corporation's over-indebtedness at the time when its board of directors should have filed for bankruptcy with the (higher) amount of its over-indebtedness at the time when the board of directors actually filed for bankruptcy.

Under the Swiss version of the business judgement rule, courts are held to restrain themselves in their assessment of business judgements that were made on an informed basis and arrived at by way of a flawless decision-making process, free from conflicts of interests. If the decision-making process did meet those high standards, courts will merely assess whether the business judgement was, in substance, justifiable. If the decision-making process did not meet those high standards, courts will assess whether the business judgement appears to have been faulty in the given situation. In the context of insolvent trading, it will likely be difficult for directors to argue that their business judgement did not constitute a breach of their statutory duties if the decision to refrain from filing for bankruptcy did not meet those high standards.

Civil liability may also extend to managers and shadow directors. Managers are persons to whom the corporation's board of directors has

formally delegated the task of directing the affairs of the corporation. By contrast, a shadow director is a person who – without being formally elected to a corporation's board of directors – takes decisions that are meant to be taken by the board of directors or who de facto directs the affairs of the corporation. While there are no clear-cut criteria according to which shadow directorship is determined, the risk of qualifying as a shadow director increases where there has been systematic and repeated decision-making in areas that typically fall within the competence of the board of directors, such as strategy, financial planning, financing/investment decisions, etc. Shadow directorship is not limited to individuals but also extends to legal entities. Against this background, the question arises whether a financial creditor could qualify as its debtor's shadow director and as such be held liable for insolvent trading.

LIABILITY OF FINANCIAL CREDITORS AS SHADOW DIRECTORS?

According to Swiss case law and predominant scholarly writing, a person who merely exerts influence on the administration and management of a corporation by exercising contractually granted rights to safeguard its own legitimate interests does not qualify as a shadow director.

The Swiss Federal Supreme Court, Switzerland's highest court, affirmed in a 1981 decision the shadow directorship of representatives of a Swiss bank who acted as "silent directors" of a financially troubled construction company. The bank had previously participated in two capital increases and acted as financial advisor to the company's sole director. The bank representatives frequently participated in board meetings. The court held that through their participation in those meetings, the bank representatives had a considerable influence on, or actively participated in, the company's decision-making process. According to the court, the significance of the participation of the bank representatives in those meetings was mainly owing to the fact that the board of directors consisted of only one member and that the purpose of the meetings was to inform the bank representatives about the matters under negotiation and to give them the opportunity to comment on the resolutions to be passed. It was considered irrelevant whether or not formal votes were taken.

In a 2009 decision, the Swiss Federal Supreme Court held that a bank was not to be regarded as a shadow director if it merely takes measures to defend its interests as a creditor. The court stated that the close monitoring of the borrower's development, the request to provide financial information or additional security and the acceleration of loans did not qualify as interference in the borrower's management, which would imply a status as shadow director.

Finally, the Swiss Federal Supreme Court concluded in a 2014 decision that a law firm was not to be qualified as its client's shadow director if, in its capacity as legal advisor, it assisted in its client's decision-making, even if it had a strong influence due to its expert knowledge. In my opinion, the same principles should apply to an advisor providing financial or restructuring advice.

It follows from the above that a financial creditor will typically not qualify as its debtor's shadow director if its actions are aimed at preserving the value of its financial commitment. That said, a financial creditor may qualify as its debtor's shadow director if it takes, repeatedly and in an institutionalised manner, decisions that typically fall within the competence of that debtor's board of directors.

Even if, in a particular case, a financial creditor was to qualify as its debtor's shadow director, it is unclear whether it could be held liable for insolvent trading. The Swiss Federal Supreme Court has repeatedly stated that a shadow director neither has a right nor an obligation to file for bankruptcy on behalf of the corporation. However, the court has held in obiter dicta that liability could extend to a shadow director if it has dissuaded the board of directors from filing for bankruptcy or if it has failed to inform the board of the existence of the over-indebtedness. Given the vagueness of the court's statement, it remains unclear under what conditions a shadow director would be considered to have dissuaded the board of directors from filing for bankruptcy. Also, it remains to be seen how the notion of a shadow director's failure to inform the board of directors of the existence of the over-indebtedness will relate to the directors' very own duty to inform themselves of the corporation's financial condition.

CONCLUDING REMARKS

While the concept of insolvent trading may not be new to many international market participants, it is important to remember that unlike in several other jurisdictions, a balance sheet test is applied in Switzerland in order to determine the starting point for insolvent trading. Hence, even a corporation that is still perfectly able to pay its debts as and when they fall due may already be trading wrongfully, which may result in personal civil liability for damages on the part of its directors. Liability may also extend to managers and shadow directors, although a financial creditor will typically not qualify as its debtor's shadow director if its actions are aimed at preserving the value of its financial commitment. ■

France

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The decree of the Conseil d'Etat of 24 December 2018 providing for the pledge of financial securities represented and transferred via the blockchain[1] dismisses the notion of a pledged account but seems to preserve the original legal effect introduced by French law of a pledged financial securities account.

PLEDGES OF FINANCIAL SECURITIES REGISTERED ON A DLT (BLOCKCHAIN): RECOGNITION OF A FICTITIOUS UNIVERSALITY

Blockchain technology is having a disruptive effect on the way unlisted intermediated financial securities are represented and transferred. Conventional financial securities are represented and transferred by an entry into an account held by the issuer or by an authorised intermediary. This entry in the account of the holder of the financial securities evidences title to the security and records its ownership and transfer. On the contrary, in the case of blockchain technology, securities movements constitute coded and authenticated blocks of