



Corporate Law Newsletter

Intercompany Loans May Result in a Limitation of the Amount that May be Distributed as a Dividend

Decision of the Federal Supreme Court

The still ongoing liquidation of the once high flying Swissair continues to be a fountain of interesting court decisions. In the decision of the Federal Supreme Court of October 16, 2014, the court had to consider the principles of the limitations of financial assistance and its impact on distributable profits.¹

The Federal Supreme Court had to decide on the liability of the company's auditors, who have certified a dividend proposal in the amount of CHF 28.5 Million as compliant with the law and the company's articles.

The facts of the case are quite complicated, since it involved a cash pooling arrangement for the Swissair group companies. In essence the plaintiff argued that although the company had a balance sheet profit of CHF 29.17 Million as per the end of 2000, the up- and cross stream intercompany loans granted by the company in the amount of CHF 23.65 Million limited the distributable profit. Since these intercompany loans have not been granted at arm's length terms and conditions, these amounts should have been deducted from the available distributable profit and thus reduce the amount to be paid out as a dividend.

Reasoning

The Federal Supreme Court argued that one of the key principles of the Swiss law on stock companies is the protection of the capital. A host of mandatory provisions exist under Swiss law, which assure that a corporation maintains a net assets (assets minus liabilities) at least equal to the share capital and its statutory reserves. Amongst others, Art. 680 para. 2 Swiss Code of Obligation ("CO") provides that a shareholder may not request the repayment of the capital paid in for the subscription of shares. This principle was extended by the courts to include the prohibition of repayment of capital in general. Except

under the context of a formal decrease of the share capital which provides for adequate creditor protection, a repayment of the capital to a shareholder is not permitted and the shareholder is under an obligation to reimburse the amount so received. Furthermore the provisions on declaration of dividends, pursuant to which dividends may be paid only out of the balance sheet profit and specific reserves as set out in the audited accounts complete the Swiss frame work of capital protection.

These rules also apply to up- and cross stream loans in as far as such loans are not granted at arm's length terms and conditions. It has been argued in legal doctrine that up- and cross stream loans which are not granted at third party market conditions block the amounts available for profit distribution in the amount of such loans.

The Federal Supreme Court upheld the lower courts finding that the loans in question did not meet the test of third party market conditions and hence held that these loans acted to reduce the distributable profit.

The Federal Supreme Court had also to address the question that has remained unanswered so far, namely, whether paid in surplus which must be allocated to the company's general reserves can be used for profit distribution. The Federal Supreme Court followed the prevailing legal doctrine and found paid in surplus distributable to the extent the general reserves exceeded 50%² of the company's share capital.

Comment

The Federal Supreme Court's decision provides for helpful guidance and clarification in connection with intercompany loans and the availability of paid in surplus for profit distribution.

The company's directors and auditors are well advised to introduce a separate item for up- and cross

¹ Federal Supreme Court Decision 140 III 533

² 20% for qualified holding companies



stream intercompany loans and to treat them as a liability for the purposes of the determination of the profit available for distribution to the shareholders. In our view the same reasoning must apply for up- or cross-stream securities granted by as Swiss company unless granted at arm's length terms and conditions.

The determination whether a up- or cross stream loan or security interest is granted at arm's length terms and conditions is not an easy one. The following elements may provide guidance:

- Is a formal agreement in place setting out the usual terms such as interest rate, maturity, termination, collateral etc.?
- Did the company make an assessment of and document that the agreement fulfils a third party test?
- Do the interest terms and conditions match market standards?
- Do the terms and conditions for maturity and termination right match market standards?
- Is the amortisation of the loan market standard?
- Are there market terms and conditions for collateral?
- Is the counterparty's credit risk assessed and continuously monitored?
- Is interest paid regularly or added to the principal?
- Is the exposure vis-à-vis the intercompany debtor reasonable, considering the lender's balance sheet?

The above list, which is taken from the publication of the Chamber for Auditors and Fiscal Experts, dated December 17, 2014 is not exhaustive and each case will need to be looked upon and assessed individually.

However, in our experience, intercompany loans are rarely granted at market conditions and therefore the prudent approach is to block the amounts in question for the purpose of profit distribution and to avoid personal liability of the directors.

March 18, 2015

Arlette Pfister and David Känzig

For further information please contact:

Arlette Pfister (a.pfister@thouvenin.com) or

David Känzig (d.kaenzig@thouvenin.com)

THOUVENIN rechtsanwälte compact

THOUVENIN rechtsanwälte is an innovative and partner-centred law firm with more than three decades of experience in business law. Our experienced corporate law team advises on a wide range of contentious and non-contentious issues related to corporate law, restructuring, financing. Members of our corporate team have been ranked by Chambers & Partners and legal 500.

More detailed information and further corporate law Newsletters can be accessed at www.thouvenin.com